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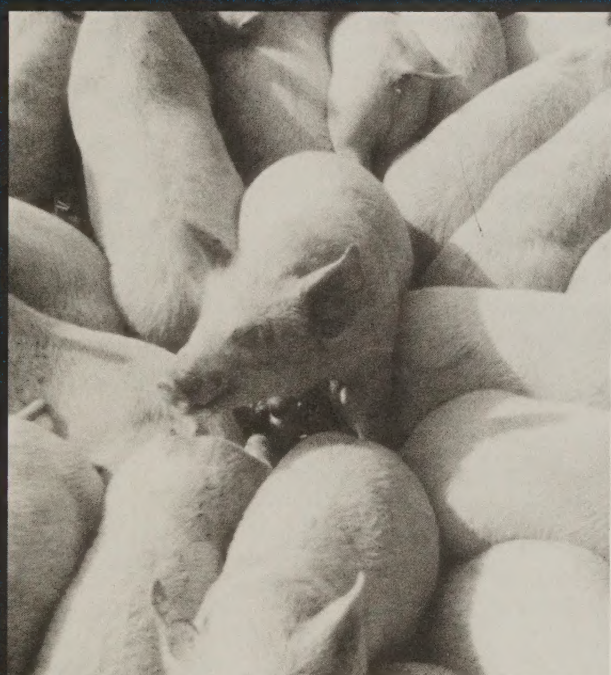
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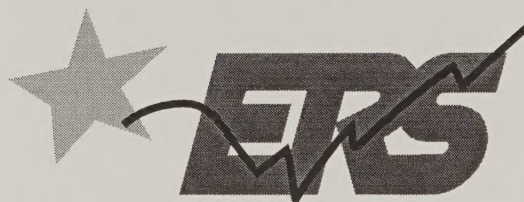
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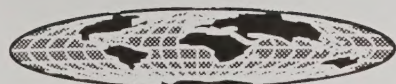
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INTERNATIONAL AGRICULTURE AND TRADE REPORTS

**United States
Department of
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Economic
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EUROPE

Situation and Outlook Series

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Foreword

The Uruguay Round of negotiations, concluded in April 1994, brought agricultural trade more fully under GATT/WTO disciplines. Under the Uruguay Round Agreement on Agriculture (URAA), countries agreed to improve access to their domestic markets by improving transparency in the application of border measures and providing minimum import opportunities. They also agreed to cap subsidies on domestic production and exports, and to reduce these amounts over the implementation period—1995-2000 for developed and 1995-2004 for developing countries. Other important milestones of the Uruguay Round related to agriculture included agreements on Sanitary and Phytosanitary Measures (SPS) and Technical Barriers to Trade (TBT), as well as a definition of state trading activities (Understanding of Article XVII of GATT 1994). The SPS and TBT agreements provide objective frameworks of “sound science” and “equivalency” that all import measures related to public health or national standards should observe. The WTO also requires members to notify state trading enterprises (STEs), a first step towards clearer rules that ensure STEs are not used to circumvent a country’s URAA commitments. Each year, countries provide information on commitments, changes in policies, and related information on their STEs.

The European Union (EU) and countries of Central and Eastern Europe (CEE) now find themselves in the third year of Uruguay Round implementation. Three of the articles contained in this year’s *Europe* report examine possible short- and long-term impacts resulting from the EU’s commitments under the URAA. The first article examines how the EU’s market access commitments—particularly its tariff-rate quotas (TRQs)—affect the level and country distribution of EU imports. Under the system of TRQs, EU agricultural imports are estimated to expand only 2 percent over total current levels for a limited number of meat and dairy products. Countries of Central and Eastern Europe stand to gain the most from these new import opportunities.

The second article examines whether the EU’s export subsidy reduction commitments under the Uruguay Round will affect its ability to export surpluses of grain and other commodities requiring subsidies. Based on data available so far, it appears the EU could have difficulty meeting 2000/01 export subsidy commitment levels for cheese, beef, olive oil, and other milk products. High world prices in recent years have made EU export subsidy reductions for grains easy to meet, but this could change by 2000/01.

The third article examines the implications of proposed changes to the CAP for grain production and the EU’s ability to meet challenges posed by URAA commitments as well as EU enlargement to the East. Under CAP modifications as currently proposed by the Commission, the elimination of set-aside will increase EU production of grains, resulting in rising grain surpluses. A reduced intervention price for grains should allow the EU to export its wheat without subsidy. However, because all grains will be subject to a unified intervention price, the internal EU barley price is expected to remain above the world price. Therefore, the EU will need to continue subsidizing its barley exports. It remains unclear whether rising barley surpluses under the proposed CAP changes would push the EU above its 2000/01 export subsidy volume ceiling for coarse grains. 1995/96 volume of subsidized exports was only 60 percent of the 2000/01 ceiling.

The proposed CAP changes also aim to decrease the budgetary cost of enlargement to Eastern Europe as well as help an enlarged EU keep within its URAA commitments. These issues could be resolved by lowering CAP intervention prices and not extending compensatory payments to the CEEs.

A special article examines the role of state trading in Central and Eastern Europe. Four of the CEEs—Poland, Slovenia, Slovakia and the Czech Republic—have notified the WTO of the existence of state trading enterprises (STEs). The STEs notified by these countries are regulatory agencies that carry out intervention purchasing and administer export subsidies. But ambiguities persist despite these notifications. There are state-owned enterprises in other CEEs which meet the WTO definition of an STE but which have not been notified. Among those STEs which have been notified, a lack of good data makes it difficult to evaluate the full impact of state trading.

This year’s *Europe* report also raises a number of issues the EU must face in the coming round of WTO negotiations on agricultural trade, scheduled to begin at the end of 1999. After 2000/01, EU market access opportunities are expected to remain limited for some products, particularly for pork and butter, but also eggs and poultry. Other WTO members may demand further increases in EU market access for such products. While proposed CAP changes may increase the EU’s willingness to agree to further reductions in export subsidies and market price supports, they are also likely to increase its reluctance to eliminate the Blue Box, which exempts from reduction programs that are production-limiting and meet specific criteria. The Blue Box includes EU compensatory payments for arable crops and livestock. However, some WTO members will probably insist not only on further reductions in export subsidies and market price support, but also on eliminating the Blue Box exemptions.

On the surface, it would appear that CEE state trading institutions are not used to circumvent the commitments made to the WTO on import tariffs and export subsidies. Yet, state trading will also be an issue for the next round, not only for CEEs but other countries. For one thing, the definition of state trading is vague, allowing some governments to notify the WTO that they have no state trading, when in fact they do have institutions which meet those criteria. Another major problem is that these institutions in many cases affect levels of imports and exports in ways that are not easily measured. Published tariff rates and PSE calculations based on price gaps do not tell the whole story.

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TRQs Have Little Impact on EU Market Access, While CEEs May Benefit

Along with reducing domestic support and export subsidies, the Uruguay Round Agreement on Agriculture (URAA) aimed at improving market access. This article estimates the potential impact of the European Union's (EU) new market access commitments under the Uruguay Round on the overall level and the source of its agricultural imports. The EU's system of TRQs that are notified under the Uruguay Round will have only a limited impact on the level of EU imports. In terms of their effects on EU import source, countries of Central and Eastern Europe that concluded Europe Agreements with the EU stand to gain a large share of the new imports created under the TRQs.
[Todd Morath]

Introduction

The EU's system of tariff-rate quotas (TRQs)¹ that are notified under the Uruguay Round will have only a limited impact on the level of EU imports. EU agricultural imports under its Uruguay Round TRQs are estimated to increase almost \$1 billion by 2000/01, the final year of URAA implementation, representing about 2 percent of current agricultural imports. From this standpoint, new EU market access opportunities under the Uruguay Round are limited. In terms of their effects on EU import source, countries of Central and Eastern Europe that concluded Europe Agreements with the EU (CEE-10)² stand to gain a large share of the new imports created under the TRQs. The CEE-10 benefit from lower tariffs for most products, while the EU counts imports under the Europe Agreements against the utilization of its Uruguay Round TRQs. The CEE-10 are expected to take greatest advantage of new EU market access for pork and butter, whereas the benefits of new EU market access will likely be spread among a greater number of exporting countries for poultry, cheese, egg products, and skimmed milk powder. U.S. exporters are most likely to be competitive in the EU's TRQs for eggs, egg products, some pork loins, and some cheeses.

This article does not address the impact of Uruguay Round tariff reductions or the "margin of preference" arrangement for grains on EU imports. Additionally, it does not consider the impact of non-tariff measures that restrict imports such as technical barriers to trade (TBTs) or sanitary and phytosanitary (SPS) measures.

Why Market Access Under the Uruguay Round Agreement on Agriculture: A Brief Overview

Market access, in short, is the extent that a country allows the importation of foreign products. Prior to the Uruguay Round, countries used both tariffs and non-tariff measures—such as quotas and variable levies—to regulate imports of agricultural goods. The Uruguay Round Agreement on Agriculture (URAA) brought many non-tariff measures in agriculture under WTO disciplines, so that since July 1, 1995, all import protection takes the form of ad-valorem tariffs (equal to a percentage of the product's value) or specific tariffs (per unit weight, volume, by the piece, etc.). Countries bound their tariffs at maximum levels and are reducing them over the implementation period (36 percent on average between 1995/96 and 2000/01 for developed countries). Tariff-rate quotas (TRQs) are now used to import a fixed quantity of product at a tariff below the out-of-quota most-favored-nation (MFN) tariff. For the EU, in many cases MFN tariffs were determined under the process of tariffication.

Why did the Uruguay Round replace quotas and similar measures (such as voluntary restraint agreements) with TRQs, which also distort trade? The process of tariffication involved converting non-tariff barriers (NTBs) into tariffs. For many countries like the EU, protectionist NTBs were thereby converted into equally protectionist tariffs. Although it was not supposed to, protection potentially increased for some products through "dirty tariffication," where countries used the lowest available import price and the highest internal market price to overstate the base tariff. Therefore, countries were required to establish TRQs (1) to preserve market access by ensuring that historical quantities continued to be imported ("current access" TRQs), and (2) as a means of providing for additional imports under minimum access, a guarantee that at least some new quantities would be provided import opportunities under non-prohibitive tariffs.

¹Readers who are unfamiliar with tariff-rate quotas should refer to the box defining key terms related to TRQs.

²The CEE-10 are: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia.

Key Terms Related to Tariff-Rate Quotas (TRQs)

- *Current access TRQs* are those that maintain historical imports.
- *Minimum access TRQs* create additional import opportunities for products previously covered by a non-tariff barrier (e.g., import ban or high variable levy) whose imports did not equal at least 5 percent of domestic consumption in the 1986-88 base period.
- *Out-of-quota tariffs* are the higher tariffs applying to imports outside a TRQ quantity (once a TRQ has been fully utilized).
- *In-quota (TRQ) tariffs* are the lower tariffs applying to imports within the limited TRQ quantity.

There are two country-origin types of both out-of-quota and in-quota tariffs: Most-favored-nation (MFN) and preferential:

- **MFN tariffs** are those applied to all countries that are signatories to the Uruguay Round. The *in-quota MFN tariff* is that for which all countries are eligible within a fixed TRQ quantity. The *out-of-quota MFN tariff* is the higher tariff applicable to all countries above the fixed TRQ quantity.
- **Preferential tariffs** are those tariffs from which one or more, but not all, countries benefit within the scope of the bilateral, regional, or preferential trade agreements (e.g., the Europe Agreements, the European Economic Area, the Lome Convention, the Generalized System of Preferences). These tariff preferences have created numerous departures from the MFN principle, namely that WTO members should apply the same tariff to imports from other WTO members. The *in-quota preferential tariff* is that which the EU grants to specific countries for a limited quantity. Additionally, under some trade agreements (including the Europe Agreements) specific countries benefit from tariff preferences outside their allocated TRQ quantities or from tariff preferences with no quantitative restriction: These are *out-of-quota preferential tariffs*.

Whereas an out-of-quota preferential tariff is always lower than the corresponding out-of-quota MFN tariff, an in-quota preferential tariff is not necessarily lower than the corresponding in-quota MFN tariff. This is because the EU bases its calculations for in-quota preferential tariffs on a percentage of the *out-of-quota* MFN tariff, not the in-quota MFN tariff. For most countries under the Europe Agreements, in-quota preferential tariffs are currently equal to one-fifth of the corresponding out-of-quota MFN tariff. The CEE-10 do not benefit from lower tariffs under the Europe Agreements for some TRQ products. Nevertheless, in-quota preferential tariffs for imports into the EU are usually lower than their corresponding in-quota MFN tariffs.

EU tariff structure for TRQ products

ELIGIBLE COUNTRY SOURCE	TYPE OF TARIFF	
	<i>Out-of-quota</i> (no quantitative restriction)	<i>In-quota</i> (with quantitative restriction)
<i>Most Favored Nation</i> (all WTO members)	Bound tariff to be reduced 36% on average by 2000/01	Lower tariff within fixed TRQ quantity. Applies to minimum access TRQs as well as some current access TRQs.
<i>Preferential</i> (country-specific)	Normally calculated as percentage of MFN out-of-quota tariff.	Also calculated as percentage of MFN out-of-quota tariff, but applicable only within country-specific TRQ quantity. As they are based on the out-of-quota tariff, may be either more or less advantageous than the MFN in-quota tariff.

Countries established "minimum access" TRQs for quantities of imports needed to reach a negotiated amount, often 5 percent of base-period (1986-88) domestic consumption, by the end of the implementation period. It is important to note that neither the current nor the minimum access TRQs constitute a minimum purchase agreement. They provide only the "opportunity" to import under the advantage of a preferential or suspended tariff.

From a political standpoint, TRQs also served to meet the concerns of traditional exporters. Beneficiaries of the old country-specific quotas, voluntary restraint agreements, and similar schemes were intent on preserving their previous access. Though continuing the practice of country allocations (which occurred in some but not all cases) meant that competition among exporting countries would remain restricted, it would have been very difficult as a matter of

policy to disrupt historical trade patterns under existing bilateral, regional, and preferential trade agreements.

From an economic perspective, TRQs are preferable to quotas because under certain conditions they cause less distortion to trade flows. A quota seriously distorts trade by banning imports above a fixed quantity. Once the quota ceiling is reached, market forces of supply and demand can play no role. A TRQ may cause less trade distortion as it allows for imports—albeit at a higher out-of-quota tariff—above the fixed quantity ceiling. However, a TRQ distorts trade less than a quota only if its out-of-quota tariff is not prohibitively high.

Additional benefits of the tariffication process include more transparency in the application of border measures. The bound tariffs and TRQs resulting from this process now provide a sound basis in future rounds from which to negotiate further tariff reductions or increased TRQ import opportunities.

In sum, current access TRQs ensure that imports will be provided access no worse than historical levels while minimum access TRQs create the opportunity for new imports.

Uruguay Round TRQs Expand EU Imports 2 Percent by 2000/01

An analysis of two types of URAA arrangements—current access TRQs and minimum access TRQs—reveals that their combined impact on the level of EU imports will be minimal. None of the EU's current access TRQs under the Uruguay Round will have an impact on the level or country source of EU imports, other than by putting access opportunities on a firmer footing. By their very definition and design, the current access TRQs have no net effect on imports as these arrangements under the URAA serve only to maintain historical import levels. In addition, the EU's minimum access TRQs that are compensation for the enlargements to Austria, Finland, and Sweden (1995), as well as from the 1992 GATT dispute on oilseeds, should be excluded from the analysis. These include the minimum access TRQs for 20,000 tons of beef, 15,500 tons of poultry meat, 500,000 tons of corn, and 300,000 tons of high quality wheat for the GATT oilseeds panel dispute, as well as 700 tons of poultry meat, 63,000 tons of semi-milled or wholly milled rice, 20,000 tons of husked (brown) rice, 50,000 tons of durum wheat, 21,000 tons of oats, and 10,000 tons of worked oats for the 1995 enlargement.

Therefore, only EU minimum access commitments that were not awarded as compensation will potentially increase imports. These are the EU's minimum access TRQs for pork meats and products, some poultry meats, butter, cheese, skimmed milk powder, eggs and yolks, and egg albumin.

Uruguay Round TRQs Determine Only 10 Percent of EU Agricultural Imports

Based on quantities notified by the EU to the WTO and using average import prices, 1996 EU imports under its Uruguay Round TRQs (current access and minimum access combined) made up only 11 percent of its total agricultural imports, while imports under the minimum access TRQs alone accounted for just 1 percent of the total. The EU continues to import most of its agricultural goods under TRQs and other preferential tariff arrangements that were not included in its URAA market access schedule, or under relatively low MFN import tariffs (most of which were low prior to the Uruguay Round).

Over the years, the EU has granted numerous import concessions under bilateral, regional, and preferential trade agreements, many of which were not included in the EU's Uruguay Round commitments. Some of these EU import concessions involve preferential TRQs, while others involve tariff preferences not subject to quantitative restriction. Some of the more important arrangements are listed in Appendix 1. They include preferential-tariff imports into the EU for tropical oils, cocoa, coffee, tea, spices, cheese, fresh tomatoes, citrus fruits, fruit juices, prepared or preserved fruits and nuts, olive oil, prepared or preserved meats, and pet food.

Also, the EU applies relatively low import tariffs on an MFN basis for certain products that are used as inputs into animal feeding or for processed foods. Important examples include soybeans, oil cakes, dried peas and beans, honey, tobacco leaf, and nuts—in 1995, imports of these 7 products alone made up about one-quarter of total EU agricultural imports. Finally, EU imports include specialty products such as alcoholic beverages that, although subject to high tariffs, have established important niche markets among well-to-do EU consumers.

These minimum access TRQs will have only a limited impact on EU imports (table 1). Assuming that all TRQs are fully utilized, EU imports are expected to increase about 780 million ECU (\$950 million) by 2000/01, roughly 2 percent of current EU agricultural imports (around \$50 billion in 1996). The import estimate involves the simplified assumption that average import prices will remain the same as those calculated during 1995/96, the first year of URAA implementation. It ignores any changes in quality, exchange rates, or inflation; average import prices within each product group are not trade-weighted.

Europe Agreements Likely To Affect EU Import Source for Most Minimum Access TRQs

Under the Uruguay Round, EU imports under the Europe Agreements may count towards utilization of its minimum

Table 1--New EU-15 Import Opportunities Under Minimum Access TRQs, 2000/01

Minimum access product	(1) Min. access TRQs, 2000/01 (1,000 tons)	(2) Avg. import price, 1995/96 (1,000 Ecu/ton)	(3) = (1) * (2) Estimated value (Mil. Ecu)
Pork meats	66.5	1.6	105
Prepared/preserved pork	9.1	5.9	54
Poultry meats			
Chicken carcass	6.2	1.5	9
Chicken cuts 1/	4.0	2.6	10
Turkey meats	3.5	2.8	10
Butter	10.0	2.3	23
Eggs/yolks	142.0	1.3	188
Cheese	83.4	3.0	253
Skimmed milk powder	68.0	1.6	106
Egg albumin 2/	7.8	2.7	21
Total			778

1/ Tariff headings 02071310/1320/1330/1340/1350/1360/1370/1420/1430/1440/1460.

2/ In egg albumin equivalent.

Sources: Eurostat, WTO schedule CXL (EU-15).

Minimum access TRQ quantities awarded as GATT compensation are not included (this includes those for beef, some poultry cuts, and grains).

access TRQs for most pork products, poultry, cheese, skimmed milk powder, and egg products (the arrangement is identical for U.S. imports of some products from Mexico and Canada under NAFTA). The CEE-10 benefit from a tariff preference for most of the minimum access TRQs that is lower than the in-quota MFN tariff, and the CEE-10 are significant, low-cost suppliers of most of the products concerned. For these reasons, the CEE-10 stand to gain most from the new imports created by the EU's minimum access

Table 2--Minimum Access TRQ products: Average MFN and Europe Agreement Tariffs, 1995/96

Minimum access product	Out-of-quota MFN	In-quota MFN	In-quota preferential tariff: Europe Agreements 1/
		-Percent-	
Beef	209.0	16	32 2/
Pork meats	72.5	22	14
Prepared/preserved pork	52.3	8	10 2/
Poultry meats	43.6	11	9
Butter	123.6	39	25
Eggs/yolks	55.2	19	11
Cheese	88.0	21	20
Skimmed milk powder	91.8	30	18
Egg albumin	54.3	18	n/a

1/ Average tariffs do not include those for the Baltics, which benefited from only a 60 percent reduction.

2/ Preferential tariffs under the Europe Agreements are calculated as a percentage of the out-of-quota MFN rate; for this reason, they may exceed the corresponding in-quota MFN tariff.

Sources: Eurostat; Official Journal of the European Communities--

Taric; CAP Monitor.

Tariffs are expressed as simple averages across minimum access TRQ tariff lines.

Tariffs are expressed in ad-valorem equivalents based on average import prices in 1995/96.

TRQs. The geographic proximity of the CEE-10 provides an additional export advantage.

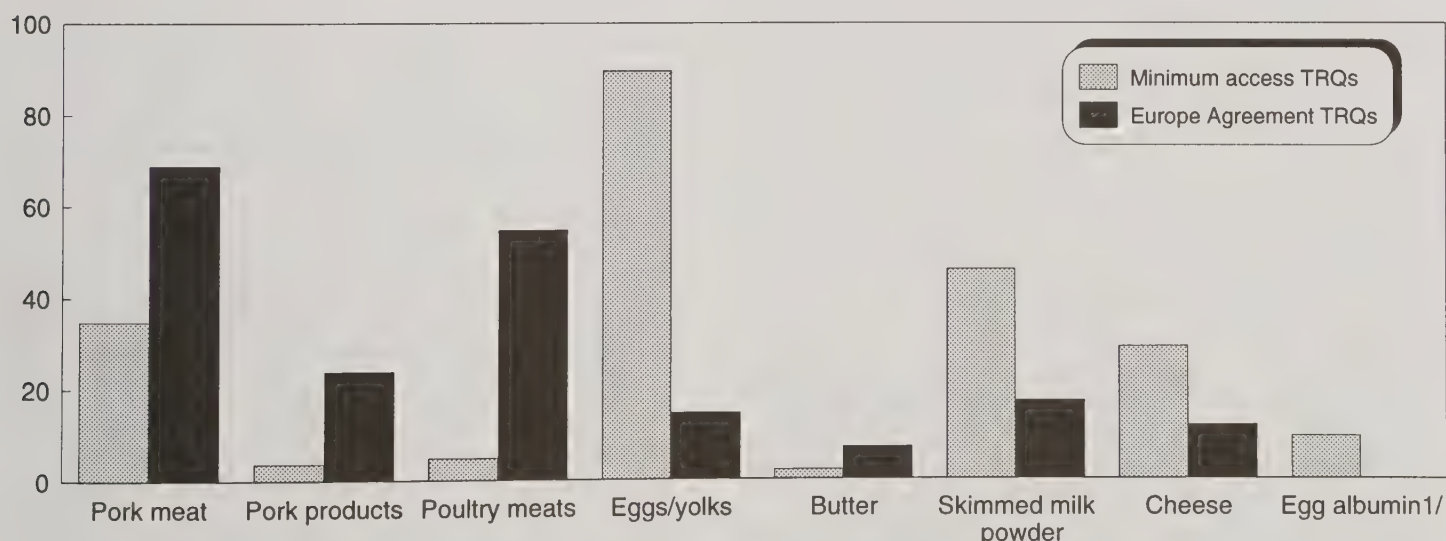
Although under the Europe Agreements the CEE-10 benefit from tariff preferences that are often lower than in-quota MFN levels, they do so only within limited quantities that vary considerably by product category. When comparing

Figure 1

Europe Agreement TRQs Count Towards Utilization of the EU's Minimum Access TRQs

Europe Agreement TRQs Exceed Uruguay Round TRQs for Pork, Poultry, Butter

1,000 tons



1/ TRQ notified in eggshell equivalent.

Sources: EU-15 market access schedule CXL; Europe Agreements; CAP Monitor.

Minimum access TRQs that were awarded as compensation are not included.

TRQ comparisons in 1996/97 for all products except 1997/98 for pork.

TRQ quantities under the Uruguay Round and the Europe Agreements, it becomes clearer what share of the EU's Uruguay Round TRQs might be captured by the CEE-10.

Pork meats and products

The CEE-10, in particular Hungary, have historically dominated EU imports of pork meats and products under the minimum access tariff lines, with a share exceeding 90 percent. With preferential tariffs marginally lower than the in-quota MFN tariff, and with current TRQ quantities under the Europe Agreements (92,700 tons) already exceeding the EU's URAA commitments in 2000/01 (75,600 tons), much of this pork is likely to be imported under the Europe Agreements and count against the EU's Uruguay Round TRQs. However, U.S. exporters might be competitive in certain cuts such as loins. One minimum access TRQ provides for zero-tariff imports of 7,000 tons of fresh/chilled pork loins and frozen bellies. According to the EU's URAA schedule, imports under the Europe Agreements may not count against utilization of this particular TRQ.

Poultry meats

Traditional exporters of poultry to the EU include Argentina, Brazil, the CEE-10, China, and countries of Southeast Asia. Europe Agreement TRQs for poultry meats also covered under the EU's minimum access TRQs currently total about 55,000 tons, almost four times the EU's final minimum access TRQ quantities under the Uruguay Round that were not awarded as a result of the 1992 oilseeds panel dispute or the EFTA enlargement (13,700 tons in 2000/01). For fresh/chilled poultry meats—11,200 tons of the Uruguay Round total—the CEE-10 benefit from preferential tariffs that are marginally lower than the in-quota MFN tariff. These quantities include products for which the CEE-10 are the EU's main supplier. Therefore, we can expect most of the fresh/chilled quantities to be imported under the Europe Agreements and count against the Uruguay Round TRQs. For the remaining 2,500 tons of frozen turkey, the CEE-10 do not have a tariff advantage vis-a-vis the zero percent in-quota MFN tariff. Therefore, all third countries have the same opportunity to benefit from the minimum access TRQs for frozen turkey. Even if the United States can resolve sanitary issues that continue to block its poultry meat exports to the EU, U.S. exporters may be able to gain only a small portion of the EU frozen poultry meat TRQs.

Cheese

Europe Agreement TRQs for cheeses also covered under the EU's minimum access TRQs are currently fixed at 11,700 tons, about one-third of the 1996/97 minimum access TRQs. However, because preferential tariffs under the Europe Agreements are roughly equal to the corresponding in-quota MFN tariffs, all third countries have the same potential to benefit from the EU's minimum access TRQs for cheese. Among these TRQs, U.S. producers of processed cheese

appear to be benefiting most. However, in value terms U.S. cheese exports under the minimum access TRQs were small at under \$3 million in 1996.

Butter

Europe Agreement TRQs for butter are currently fixed at 7,000 tons, or more than three times the EU's 1996/97 minimum access TRQ under the Uruguay Round. Although the EU's minimum access TRQ for butter will increase to 10,000 tons by 2000/01, Europe Agreement TRQs are also likely to expand over time. As the Europe Agreements grant a tariff preference that is substantially greater than the in-quota MFN tariff, nearly all of the minimum access TRQ for butter stands to be imported from the CEE-10.

Skimmed milk powder

Europe Agreement TRQs for skimmed milk powder (SMP) are currently equal to 17,000 tons, roughly one-third of the EU's minimum access TRQ in 1996/97 (45,900 tons). As the Europe Agreements grant a tariff preference that is considerably lower than the in-quota MFN tariff, a sizable share will probably be imported from the CEE-10 and count against the Uruguay Round TRQs. Eurostat data reveal that while the EU's SMP imports have increased more than 50 million ECU from 1992 to 1996, the CEE share of total SMP import value rose from 8 percent to 75 percent. In 1996, EU imports from the CEE-10 totaled nearly three times the quantities under the Europe Agreements, so that CEE imports are also entering the EU under the larger minimum access TRQ. The high CEE-10 share of EU skimmed milk powder imports is due not only to lower tariffs, but also to CEE export subsidies which fall within the scope of their URAA commitments.

Eggs and egg products

Europe Agreement TRQs for eggs and egg products also covered under the EU's minimum access TRQs are currently equal to 14,500 tons, only 15 percent of the minimum access TRQs in 1996/97 (98,800 tons). The Europe Agreements grant tariff preferences for eggs and yolks that are marginally better than the in-quota MFN tariff, but grant no tariff preference for egg albumin. The United States and the CEE-10 are presently the main suppliers in these relatively small import markets. All countries should be on an equal footing (from an import tariff perspective) to compete for the lion's share, excluding the aforementioned quantities under the Europe Agreements. However, thus far the EU has imported only a small fraction of its minimum access TRQ for poultry eggs. In the 1995/96 marketing year, only 77 tons were imported out of more than 70,000 tons eligible for the lower tariff of 152 Ecu per ton (17 percent ad-valorem based on average import prices that year).

In terms of market share, the minimum access TRQs for egg products and egg albumin are creating opportunities for U.S.

Uruguay Round Requires Changes in EU Import Regime

The tariffication process required the EU to substantially modify its import policies. Most important was the elimination of the EU's system of variable levies. Tariffication under the Uruguay Round Agreement on Agriculture resulted in two different EU import regimes for grains and non-grain products.

For grains, the old EU system depended on a system of target (desired internal market) and threshold (minimum import) prices. To protect domestic producers, the threshold price was set considerably higher than the EU target price. As world prices fluctuated, the EU used variable import levies to bring the price of imports up to the threshold price. Under the Uruguay Round, the EU agreed to maintain a margin of preference for grains, so that imports of wheat, barley, rye, corn, and sorghum are subject to tariffs that maintain the duty-paid import price at 155 percent of the EU intervention price. (The price relationship for rice is fixed at 180 percent to 267 percent, depending on variety. Oats are not subject to the EU's intervention system and therefore have a bound tariff.) Since the Uruguay Round, the EU has replaced its threshold and target prices with a system of world (mainly U.S. market) and domestic (EU) reference prices for each of the above grains. Because the EU Commission adjusts its grain import tariffs every 2 weeks against changes in U.S. market prices, the mechanism works almost identically to a variable levy. However, an important difference is that grains are no longer subject to a minimum but rather a maximum import price. Since this is a fixed price and there can no longer be quantitative restrictions on imports, the effect of the "margin of preference" on grain imports is more similar to a bound tariff than a variable levy.

For products other than grains, including animal products, oilseeds, and horticultural products, bound tariffs now apply to EU imports. However, tariffication only partly succeeded in making EU import duties more transparent. While all tariffs are now bound, the new EU regime applies tariffs on many processed products that depend on the content of certain ingredients, and tariffs on horticultural products that depend on their import price and the season. A formula increases the tariff for processed products depending on their content of added sugar, flour, starch, or milk. The EU argues that its processors are disadvantaged by higher input costs due to domestic price support for these basic ingredients, and therefore require protection that depends on the content of these ingredients in imported goods.

In addition, the EU is permitted under the Uruguay Round to apply higher tariffs on imports of some horticultural products that enter below a fixed target price ("Entry Price System"). By controlling the duty-paid import price at a target level, the EU can insulate its domestic markets to a large extent from world price fluctuations. The Entry Price System also allows the EU to discriminate against cheaper imports. In April 1996, for example, sweet oranges with a price above 372 Ecu per ton were subject to a 13 percent ad-valorem tariff, while those below 372 Ecu per ton were subject to the same tariff plus a specific tariff of a maximum 89 Ecu per ton. Finally, the EU continues to subject certain dried fruits (raisins, currants, and sultanas) to a minimum import price. This mechanism must be replaced by 2000 to comply with the GATT.

For all products, the special agricultural safeguard clause (URAA Article 5) provides a notable derogation from the rule of bound tariffs. Under this clause, countries may *temporarily* apply extra duties for products specified in their schedules of concessions if import prices should fall more than 10 percent below a "trigger price" or if the quantity of imports rises too quickly in relation to an average over the previous three years. Each year, the EU Commission calculates the trigger price for a commodity based on a representative world market price and the cif import price. In the first year of Uruguay Round implementation (1995/96), the EU notified the WTO that it invoked the safeguard clause to increase import duties only for frozen boneless chicken, sugar, and molasses.

exports to the EU. However, while the United States was the leading exporter under these TRQs in 1996, its exports of eggs, yolks, and egg albumin to the EU accounted for a combined total of less than \$10 million. These are very small numbers relative to total U.S. agricultural exports to the EU of more than \$9 billion in 1996.

Summary

The EU's TRQs are projected to have a limited impact on the level of EU imports for a narrow range of products—pork, poultry, skimmed milk powder, butter, cheese, and eggs. EU imports under its TRQs are projected to increase

less than \$1 billion by 2000/01. In terms of the country source of EU imports, preferential tariffs under the Europe Agreements probably mean that the CEE-10 will gain the largest share of the EU's minimum access TRQs for pork and butter and a substantial share of the minimum access TRQs for skimmed milk powder and fresh/chilled poultry meats. Based on recent trends, the CEE-10 may also gain EU import share for skimmed milk powder outside the framework of the Europe Agreements. Finally, all third countries have an equal opportunity (from a tariff perspective) to export egg products and cheese under the EU's minimum access TRQs. U.S. exporters are most likely to gain a

share of the EU's minimum access TRQs for eggs, egg products, some pork loins, and some cheeses.

Uruguay Round TRQs Will Help EU Reach 5 Percent Market Access for Some Products

What impact will the EU's minimum access TRQs have on its imports measured as a share of domestic consumption? Under the Uruguay Round, all countries agreed to open new market access that would rise to a negotiated level—usually 5 percent of base period domestic consumption—by 2000/01. However, an important caveat was made during the Uruguay Round negotiations: the 5 percent target was rejected as a legally binding commitment. This means that under the WTO/URAA, the EU has to grant “market access opportunities” only for those quantities contained in its URAA schedule. Here, the 5 percent import target is simply a useful rod against which to measure EU market access for different products.

The EU's minimum access TRQs should be sufficient to reach import opportunities of roughly 5 percent of base period consumption for skimmed milk powder and cheese (see figure 2). On the other hand, the minimum access TRQs for pork, poultry, butter, and eggs do not increase import opportunities up to the 5-percent level. EU market access is estimated to reach only 0.9 percent of base period domestic consumption for pork, 3.5 percent for butter, 3.9 percent for eggs, and 4.1 percent for poultry. Using 5 percent of base period consumption as a measuring rod and EU imports between 1993 and 1994, EU import opportunities would need to increase another 580,000 tons for pork, 50,000 tons

for poultry, 35,000 tons for butter, and 50,000 tons for eggs. EU reductions in out-of-quota tariffs under the Uruguay Round may also increase imports of these products by 2000/01, but further analysis needs to be done on this subject.

Conclusions

On the eve of Uruguay Round implementation, EU market access varied considerably across products. The Uruguay Round Agreement on Agriculture began the process of liberalizing agricultural trade and improving market access for a range of products. While the EU's current access TRQs under the Uruguay Round will have no net effect on imports, its minimum access TRQs will potentially increase imports of a limited number of products. Using the import target of 5 percent of base period consumption as a measuring rod, the EU's minimum access commitments should be roughly sufficient for skimmed milk powder and cheese, but will not reach 5 percent for pork, poultry, butter, or eggs.

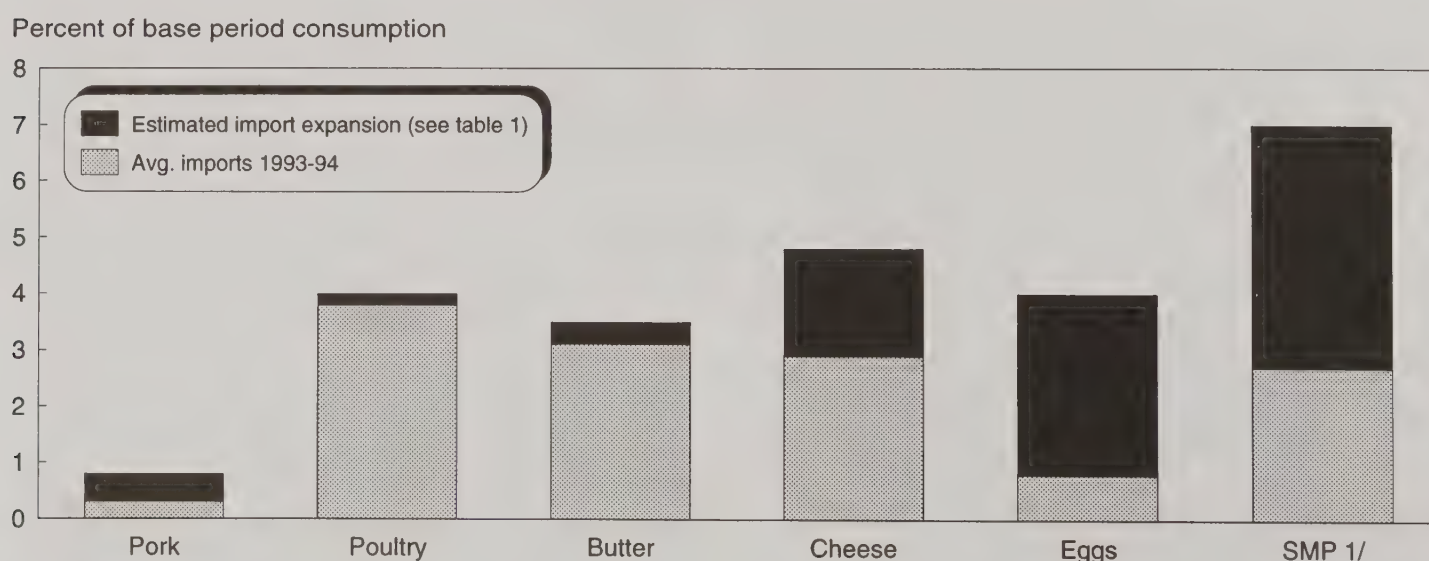
Countries of Central and Eastern Europe that have concluded Europe Agreements with the EU are projected to gain a sizable share of the trade under the minimum access TRQs, although the share varies considerably by product. While the CEE-10 are likely to take greatest advantage of the TRQs for pork and butter, the benefits of the TRQs for poultry, cheese, egg products, and skimmed milk powder will likely be spread among a greater number of exporting countries.

Further analysis is needed on the effects of tariffication to gain a more complete estimate of the Uruguay Round's effect

Figure 2

EU Market Access Could Remain Most Restricted for Pork, Butter

Average EU Imports 1993-94 and Minimum Access TRQs as Percent of Base-Period Consumption



1/ Skimmed milk powder.

Data source for EU-15 imports and base period consumption: USDA, PS&D.

Note: the 5 percent threshold is not binding under the Uruguay Round Agreement on Agriculture.

EU Allocates TRQs Like Old Quotas

The EU allocates its new tariff-rate quotas to importers like the old quotas, under import licenses. Three principal methods exist for import license allocation: on a “first come, first served” basis, based on traditional trade flows, and based on proportion to the quantities requested. These methods apply both for current and minimum access TRQs. Only companies established in the EU may apply for a license to import.

The EU allocates some of its TRQs to specific countries and others on an MFN basis to all third countries. To take advantage of a TRQ tariff preference applying to a specific country, the importer must furnish a certificate proving its origin. Certificates of origin are issued by the government of the source country. One difference between the allocation of current access and minimum access TRQs relates to which third countries are eligible as the import source. Because the EU’s current access TRQs cover imports under the old quota system, they are allocated mostly to specific countries. On the other hand, most of the EU’s minimum access TRQs are allocated on a non-country specific basis, as they are not based on historical trade.

One topic of considerable interest is the “quota rents” that are associated with the license to import or export. The value of the rent equals the imported quantity multiplied by the difference between the domestic and the duty-paid import price. Because the EU allocates its TRQs under import licenses and only companies established in the EU may apply for a license to import, normally the quota rents accrue largely to EU importers. However, for some products such as rice, milk products, and bananas, a *special export certificate* from the source country is required in order to import. This states that the importer has secured a quantity of the source country’s product. Because the export certificate is issued by the exporting country, part of the quota rent is captured by the country of origin. The issue of TRQ rents has become a point of contention between the EU and some countries of Central and Eastern Europe that are parties to the Europe Agreements, because under these agreements most of the quota rents accrue to EU importers and not CEE exporters.

Source: *Tariff-Rate Quotas in EC and GATT Law*, O’Connor and Co. (Brussels: 1997), pp.35- 38, pp.53-54.

on EU market access. Reduced tariffs over the implementation period may also have a positive effect on EU imports.

Sources

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Appendix 1--EU-15 Market Access Arrangements Under the Uruguay Round

	Grains	Oilseeds	Livestock / meats	Dairy	Horticultural products	Tropical products	Processed products
Out-of-quota import regime	Variable tariffs, bound by maintaining relationship between duty-paid import price and internal EU price	Entry subject to low or zero tariffs, no quantity restrictions 1/	Bound tariffs	Bound tariffs	Bound tariffs subject to an Entry Price System (EPS) for several products	Bound tariffs	Bound tariffs plus added content of added sugar, flour, starch, or milk
Current access TRQs under Uruguay Round	<i>Minimum purchase agreements:</i> - 2mt corn* - 300,000 t sorghum* 475,000 t brans and sharps 120,000 t barley malt mixtures 2,800 t animal feed preparations** 1,000 t broken rice** 1,300 t millet**		179,000 head cattle 145,250 t beef 323,935 t sheep and goats (carcass/live weight)	76,667 t butter 18,750 t cheese	62,660 t mushrooms 12,000 t onions, dried 90,000 t almonds 3/ 1,500 t frozen orange juice 605,000 t sweet potatoes 4,000 t new potatoes** 1,200 t carrots and turnips** 1,100 t cucumbers** 500 t sweet peppers** 6,900 t fresh non-citrus fruits**	6.85 mt manioc and other high-starch roots and tubers 10,000 t manioc starch 857,000 t bananas 4/ 2.2 mt bananas 4/ 1.39 mt refined/raw sugar 4,504 t fructose 35,000 t oranges/minneolas 10,000 t lemons	
Minimum access TRQs under Uruguay Round	300,000 t food wheat*** 500,000 t corn* 50,000 t durum wheat** 21,000 t oats** 10,000 t worked/clipped oats** 83,000 t milled/husked/broken rice**		20,000 t high quality beef *** 300 t beef** 75,600 t pork, 29,900 t fresh, chilled, or frozen poultry meats 2/	83,400 t cheese 68,000 t skimmed milk powder 157,500 t eggs and egg albumin 10,000 t butter			
Reduced-tariff and TRQ arrangements lying outside URAA; EU concessions under the General-ized System of Preferences (GSP) (selected)	Rice from ACP, OCT under Lome Convention and Egypt under bilateral agreement. Wheat and coarse grains from CEE.	Olive oil from Maghreb countries and Turkey under Mediterranean Agreements.	Live calves from CEE. Prepared/preserved meats other than pork and pet food from CEE and GSP countries (main suppliers Thailand, South Africa, China, and Hungary).	Cheese, skimmed milk powder from CEE. Cheese from Switzerland, Lichtenstein, Norway.	Fruit juices from Brazil, Argentina, and Thailand. Prepared/preserved fruits and nuts under GSP scheme and Mediterranean Agreements. Fresh tomatoes from Canary Islands (Spain).	Tropical fruits and juices under Mediterranean Agreements. Tropical oils, cocoa, coffee, tea, spices under Lome Convention.	
Notes	Part of the corn imports may include corn gluten feed and non-grain feed ingredients such as brewers' grains and citrus pulp.	1/ Under Blair House Agreement, US and EU shall agree to consult; should imports exceed base period levels.	2/ Poultry TRQs include 15,500 tons awarded as compensation for 1992 oilseeds panel dispute	Cheese TRQs include 5,000 t pizza cheese and 15,000 t cheddar.	3/ 45,000 t of which is compensation from 1995 enlargement.	4/ Banana imports are subject to two separate regimes under the Banana Framework Agreement.	

Minimum access quantities are those applicable as of July 1, 2000. * As compensation for EU enlargement to Spain and Portugal. ** As compensation for 1995 EU enlargement.

*** As compensation for 1992 GATT oilseeds dispute.

EU Export Subsidy Commitments Not Yet Binding, But Future Uncertain

Historically the European Union has relied on subsidies to export many of their agricultural commodities. The World Trade Organization (WTO) has forced member countries to reduce the volume and value of their subsidies annually until 2000/01. So far, the annual subsidy reductions have not been a binding constraint due to high world prices, which have reduced the need for subsidies. However, the EU may have difficulty meeting 2000/01 subsidy commitment levels for cheese, beef, olive oil, and other milk products (commodities where 1995/96 subsidies were over the 2000/01 commitment levels), unless they change current policies. [Susan Leetmaa]

The Uruguay Round Agreement on Agriculture (URAA) imposed stringent limits on member countries' export subsidies. The mandatory reductions have been of great concern to the European Union (EU), because it depends on export subsidies to export many of its agricultural commodities under their Common Agricultural Policy (CAP). Whether the EU meets its commitments, and how it meets them, is of interest because the United States, which competes in many of the same markets as the EU. Only data for the first year of the implementation period is available. However, these data can provide some insight as to where the EU is having a difficult time meeting the commitments, and where the reductions have not been a problem.

Over the past 2 years, world prices have been high for many commodities that the EU has typically relied on subsidies to export. As a result, subsidies have declined, and in certain cases, the EU has even imposed export taxes. These events were completely unforeseen at the time the URAA was being negotiated. If world prices fall, meeting commitments for these goods may become more difficult in the future.

Uruguay Round Agreement on Agriculture

The URAA includes limits on export subsidies. Export subsidies allow countries to export goods on the world market at a price lower than in their domestic markets. This lowers world prices and distorts markets by altering trade patterns and competitiveness between producers. Other exporters face more competition, because export subsidies drive down the prices of their goods. Countries that can afford to subsidize exports can take markets away from efficient, low cost producers. However, importing countries benefit from export subsidies by being able to purchase more of a good at a lower price.

Historically the EU has relied on subsidies to export grain. Grain prices in the EU were maintained above world levels primarily through government intervention purchases and protection from imports. This typically generated more grain than demanded in the EU. To make EU grain competitive on

world markets, and hence reduce surplus domestic supplies, the EU offered export subsidies. Most grain exports were subsidized, and government expenditures on export subsidies were often quite large (as can be seen looking at the URAA base period values).

Prior to the URAA, the United States and the EU were the two largest users of export subsidies. The EU needed export subsidies to export its commodities due to high internal price support. The United States chose to employ export subsidies in response to high export subsidies granted by other countries to their producers, mainly the European Union. During the late 1980's the United States and EU were actually engaged in a "subsidy war" where both countries would target subsidized wheat exports to the same markets, partially offsetting each other and driving each other's subsidies higher and higher.

The URAA forced developed countries, such as the United States and the European Union, to reduce the level of budgetary expenditure on export subsidies by 36 percent and to reduce the volume of subsidized exports by 21 percent. These reductions are to be made from the 1986-1990 base period level over the 1995/96-2000/01 marketing year implementation period, on a product specific basis. Developing countries are also required to reduce their export subsidies, but they have a longer implementation period and lower reductions. Member countries' WTO export subsidy schedules specify how many tons of each commodity can be exported with subsidy, and permitted subsidy expenditures for each commodity.

The text of the URAA provides some flexibility between years in terms of subsidy reductions. If a country exceeds its commitments in any of the years two through five, it must reduce subsidy levels in the next year and assure that the total cumulative value of export subsidies and volume of subsidized exports over the entire implementation period is no greater than the totals that would have resulted from full compliance with its subsidy schedules. Member countries

must meet their commitments in the last year of the implementation period (2000/01).

In 1992 the EU introduced a reform of its Common Agricultural Policy (CAP). One objective was to lower some of the internal support prices and compensate producers with direct payments. In return, farmers had to reduce their planted area by a government-established set-aside rate. Internal EU grain prices were supposed to decline 30 percent, for which farmers received direct payments from the government as compensation. CAP reform therefore reduced EU expenditures on export subsidies for certain commodities. However, even the European Commission has acknowledged that internal grain prices did not fall as much as planned, so that farmers were overcompensated. At the same time, the Commission continued to rely on subsidies to export grains, though budgetary expenditures were not as large as prior to CAP reform.

EU Notifications to the WTO on Export Subsidies

WTO members are required to notify the WTO Committee on Agriculture concerning their volume of subsidized exports, their expenditures on export subsidies, and the volume of unsubsidized exports, by commodity, as specified in the country schedules. To date, the EU has submitted notification for the 1995/96 marketing year, the first year members were required to reduce subsidies. Provisional notification was received in mid-March and final notification in late July 1997. Thus, notification for the 1996/97 marketing year is not expected until sometime in 1998.

According to European Commission data on budgetary expenditures, EU total expenditures on export subsidies have been declining since 1991. However, expenditures on export subsidies for dairy, beef, and fruits and vegetables have increased over the same period. The EU's official export subsidy notification to the WTO shows that the EU continued to reduce its overall expenditures on export subsidies in 1995/96.

EU Close to Volume Limits for Some Commodities

Although WTO members must reduce the volume of subsidized exports 21 percent over 1995/96-2000/01 period from 1986-90 levels, the 1995/96 volume commitments are roughly 20-30 percent higher than the final 2000/01 commitment levels. Based on the WTO notification for the 1995/96 marketing year, the EU was just under its 1995/96 limit on subsidized export volume for cheese, fresh fruits and vegetables, other milk products, olive oil, poultry meat, and beef (figure 3). However, the EU was over the 2000/01 limit for those goods (figure 4). Of these commodities, those that applied export subsidies to the bulk of their exports (greater than 80 percent) were olive oil, beef meat, other milk products, and cheese (figure 5). Only 50 percent of the EU's poultry and fresh fruit and vegetable exports were subsidized.

The commodities that used the least of their subsidized volume commitments (less than 50 percent of their volume commitment) for 1995/96 were rapeseed (no subsidized exports were reported to the WTO), wheat, butter, and coarse grains. Typically the EU would have subsidized up to their bound volume for wheat and coarse grains. However, global and EU grain markets were tight and prices were high during the 1995/96 marketing year and the EU used less than 50 percent of its value commitment for wheat and coarse grain. The EU did not need to subsidize as much as it had in the past, and in fact world prices were high enough that the EU taxed exports of wheat and barley for much of the marketing year in order to drive down EU prices.

Figure 3

Percentage of 1995/96 Commitment Used

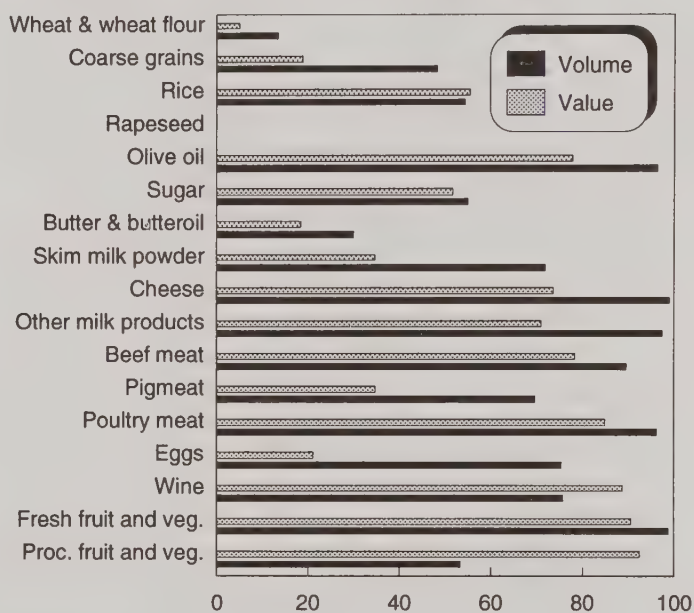


Figure 4

1995/96 Volume as Percentage of Final Commitments

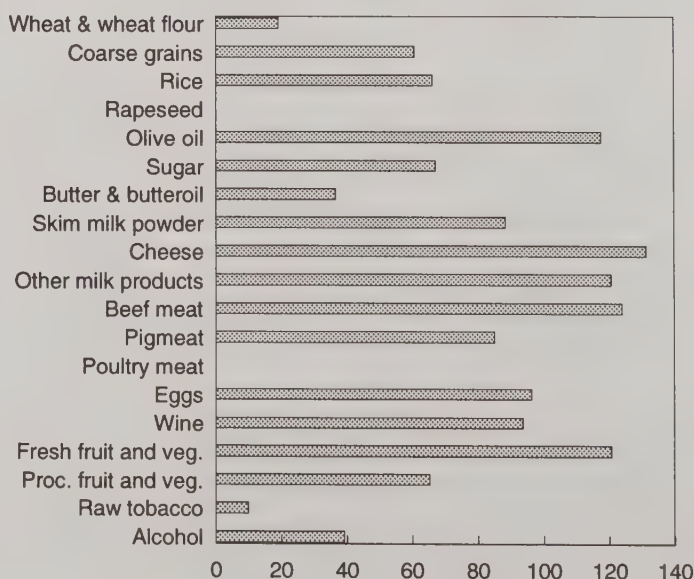
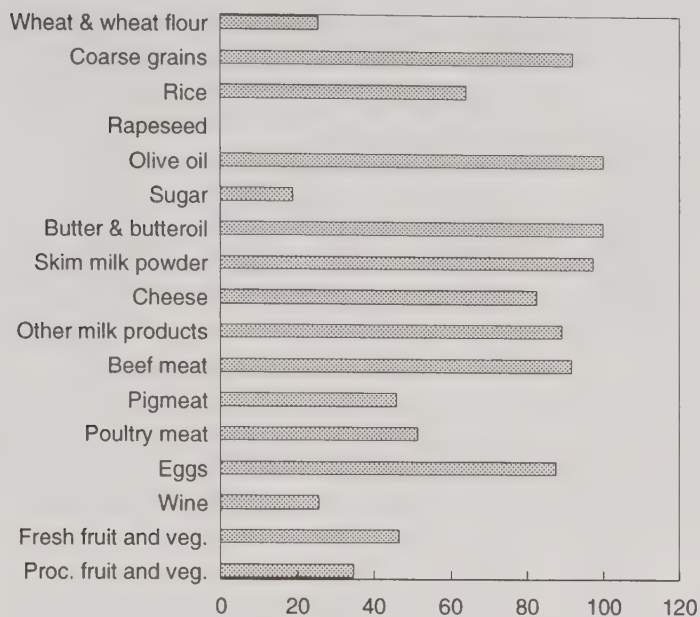


Figure 5

Percentage of 1995/96 Exports Subsidized**Value Limits Were Not Exceeded in 1995/96**

In terms of expenditures on export subsidies, the EU was closest to its 1995/96 limit for processed and fresh fruits and vegetables, wine, poultry meat, and beef. Of these, the ECU/ton export subsidy for processed fruits and vegetables was above the average allowable ECU/ton level if the total allowed expenditure was divided by the total allowed volume (table 3). The export subsidies were high partially due to low processed pineapple prices in third countries and to a small black currant harvest that increased EU producer prices. The average per ton expenditure for most commodities was less than the average permitted for the year if the permitted values were divided by permitted volumes.

In 1995/96 EU export subsidy expenditures for certain commodities were very low. Less than 20 percent of the value allotted for export subsidies was used for rapeseed (no exports were subsidized), wheat, butter and butter oil, and coarse grains. Subsidy expenditures were unusually low due to high world grain and butter prices.

Though average subsidies were lower (in value terms) than they could have been, many commodities still required subsidies on the bulk of their exports. The commodities where more than 90 percent of exports received some subsidy were skim milk powder, coarse grains, beef, olive oil and butter and butter oil (figure 5). The EU has always relied on export subsidies for these products because their internal prices are usually maintained at higher levels than world prices.

EU Wants To Carry Over Unused Subsidies

The EU has typically had to rely on export subsidies to export grain due to high price supports. However, during the 1995/96 marketing year world grain prices reached near

record highs due to tight global supplies and rising world demand. World grain prices were even higher than internal EU prices, prompting the EU to impose export taxes on wheat and barley to non-EU countries for the first time since 1974. Unlike previous years, only 25 percent of wheat exports were subsidized, whereas 92 percent of coarse grain exports were subsidized. By the end of the 1995/96 marketing year, the EU had used less than 14 percent of its subsidized wheat export volume and 48 percent of its coarse grain export volume. In value terms, the EU had only used 5 and 19 percent of its expenditure commitment to subsidize wheat and coarse grains, respectively.

Because the EU was far below its commitments in 1995/96, some in Europe have argued that the EU has the ability to apply the additional amount not used in 1995/96 to any of the years up to 1999/00. In terms of subsidized export volume, this would mean that the EU could carry over 17.6 million tons of wheat and 7 million tons of subsidized coarse grain exports at 2.2 million ECU and 1.3 million ECU respectively. Others, including the U.S., argue that flexibility provisions in the agreement are meant only to deal with situations where a country exceeds its limits and has to pay back—not as an opportunity for countries to “bank” unused subsidies.

Second Year of Implementation, 1996/97

Though we do not have any official data for the 1996/97 marketing year, which has ended for most commodities subject to export subsidy reductions, ONIC, the French grain office, estimates that EU subsidized wheat exports were roughly 13.6 million tons, still well below the 1996/97 commitment level of 19.2 (before carryover). ONIC estimates for subsidized coarse grain exports were less than 13 million tons, also less than the EU's 13.1 million ton 1996 subsidized export volume commitment. Thus, if the subsidy carryover is permissible, the EU still could subsidize roughly an additional 23.2 million tons of wheat exports and 7 million tons of coarse grain exports above its URAA commitment levels between now and June 30, 2000.

Two major questions arise: Would the EU have the capability to export that much additional grain, and could world markets absorb it? The 1997/98 world wheat crop are forecast to be of record size, and trade is expected to increase for the second year in a row. The EU reintroduced wheat export taxes in July due to appreciation of the dollar relative to European currencies, which makes EU grains more competitive in terms of dollars per ton. However, the increase in grain production has already driven down world prices, and led the EU to reintroduce small export subsidies. If the dollar remains strong, the EU is unlikely to exceed its 1997/98 subsidy allocation. However, if prices continue to fall and the dollar depreciates, the EU will need to increase its export subsidies. This may actually limit the volume that can be subsidized, since the EU has appropriated a fixed

Table 3--EU's WTO Volume and Value Export Subsidy Commitments

Commodity	Base Volume 1986-90 (a)	Schedule commitment 1995/96 (b)	EU notification 1995/96 (c)	Schedule commitment 2000/01 (d)	Value commitment 1995/96 (e)	EU value notification 1995/96 (f)	Permitted value/vol. 1995/96 (e)/(b)	Actual value/vol. 1995/96 (f)/(c)
	--Tons--			--Million ECU--		--ECU/ton--		
Wheat and wheat flour	18,276,000	20,408,100	2,768,800	14,438,000	2,309.0	118.7	113	43
Coarse grains	13,725,600	13,690,200	6,596,400	10,843,200	1,605.7	303.4	117	46
Rice	168,900	163,000	88,600	133,400	54.6	30.3	335	342
Rapeseed	131,400	126,800	0	103,800	40.7	0.0	321	0
Olive oil	145,600	140,500	135,500	115,000	79.8	62.1	568	458
Sugar	1,612,000	1,555,600	856,300	1,273,500	733.1	379.0	471	443
Butter and butteroil	505,500	487,800	146,400	399,300	1,392.1	256.2	2,854	1,750
Skim milk powder	344,900	335,000	241,200	272,500	406.2	140.9	1,213	584
Cheese	406,700	426,500	422,300	321,300	594.1	437.6	1,393	1,036
Other milk products	1,212,800	1,185,400	1,156,700	958,100	1,024.7	727.6	864	629
Beef meat	1,040,100	1,137,000	1,019,100	821,700	1,922.6	1,506.5	1,691	1,478
Pigmeat	561,400	541,800	378,200	443,500	288.8	100.5	533	266
Poultry meat	362,000	434,500	418,100	286,000	136.3	115.9	314	277
Eggs	125,000	126,100	95,100	98,800	60.7	12.9	481	136
Wine	2,917,400	2,851,400	2,161,000	2,304,700	57.5	51.1	20	24
Fruit and vegetables, fresh	953,700	920,300	909,500	753,400	77.6	70.4	84	77
Fruit and vegetables, processed	181,400	175,100	93,600	143,300	12.2	11.3	70	121
Raw tobacco	140,300	190,000	11,200	110,800	96.6	18.2	508	1,625
Alcohol	1,452,400	1,401,600	450,000	1,147,400	141.2	51.2	101	114

Source: EU WTO notification July, 1997

amount of its budget toward export subsidies. Additionally, the United States has only allocated \$150 million to the Export Enhancement Program for export subsidies in fiscal 1997/98 and has not used export subsidies for grains for over 1 year.

EU Has Implemented Component Subsidies

Clearly, some of the export subsidy limits have been binding. For example, the EU has started to export some processed cheese under the URAA export subsidy commitments for skim milk powder and butter. The EU claims that this is possible through a modified version of the "Inward Processing Relief" (IPR) system. Traditionally under the IPR, third country products were imported tariff-free, processed in the EU, and then re-exported without subsidy. Neither finished product nor components of the finished product benefited from an export subsidy. However, beginning in February 1997, new rules implemented by the EU recast traditional inward processing to allow the use of export subsidies for components of processed cheese.

The Commission argues that "Inward Processing" increases third country exports to the EU. Non-subsidized components from third countries (such as New Zealand powdered milk) may in some instances also be used. Nevertheless, cheese manufacturers such as New Zealand and the United States fear that the EU will be able to undercut their prices by allocating its export subsidies this way. Additionally, there is the fear that an EU policy of transferring subsidies from one product cate-

gory to another could spread to other agricultural products, such as using grain export subsidies to produce low cost poultry. This would weaken the WTO's export subsidy commitments, which depend on specific commodity definitions.

Future Prospects and Conclusions

The EU will have to meet the URAA limits on export subsidies by 2000/01. The Commission has discussed some policy revisions that would help it meet these goals. There has been talk of further reducing some of the internally supported prices and providing some direct payments to producers to compensate them for roughly half of the price difference. This type of reform, provided that internal prices actually fall, should reduce export subsidy expenditures.

It is difficult to assess whether the EU will be able to meet its commitments in 2000/01 based on only one year of data, especially a year such as 1995/96 where world prices of many commodities were very high. Based upon the 1995/96 notifications, projected world price levels and exchange rates, the EU will have difficulty meeting 2000/01 subsidy commitment levels for cheese, beef, olive oil, and other milk products (commodities where 1995/96 subsidies were over the 2000/01 commitment levels), unless it changes current policies. According to the official USDA baseline projections, the EU will be able to export wheat without subsidy by 2000/01. Because the EU is a major U.S. competitor in many markets, whether it meets the commitments, and how it does so bears watching.

EU Looks To Boost Competitiveness of Grain Sector, Prepare for Next WTO Round

Projected grain surpluses, WTO-imposed constraints on domestic support and export subsidies, and the looming costs of EU enlargement are causing EU policy makers to consider modifications to the Common Agricultural Policy (CAP). Recent proposals indicate moving away from market price support to increased income support, and putting the mandatory set-aside at zero percent. If these changes are implemented, grain production, exports, and compensatory payments are projected to rise relative to an unchanged CAP scenario. Agenda 2000 may indicate the EU's willingness to make further cuts in trade-distorting support in the next WTO round on agriculture, scheduled to begin in 1999. [Sharon Sheffield, Susan Leetmaa, Mary Lisa Madell]

EU Considers Possible Reform Of the CAP Crop Regime

Recent proposals to modify the Common Agricultural Policy (CAP) arable crops program are focusing on shifting support to producers from market price support to greater use of direct payments. Reasons for these proposals to reform the CAP include projected grain surpluses, WTO-imposed constraints on export subsidies and domestic support, and the future membership of Central and Eastern European (CEE) countries.

The proposed changes to the arable crops regime, which covers grains, oilseeds, and protein crops (legumes, etc.), include 1) lowering the intervention price for all grains (wheat and coarse grains) to a level closer to the world wheat price, while protein crops would still receive a higher payment, 2) equalizing the compensatory payment rate for all grains and oilseeds, which would entail an increase in the payment for grains and a reduction in the oilseeds payment, and 3) putting the compulsory set-aside, which requires producers to idle a set percentage of land in order to receive compensatory payments, at zero percent.

Two questions can be asked concerning these possible changes to the arable crops regime as it pertains to grains. First, what effect will these proposals have on grain production and trade, and second, what will be the corresponding effect on domestic support and export subsidy outlays for grains? A related issue is whether these changes will actually resolve any of the issues identified above (grain surpluses, subsidy constraints, cost of enlargement).

ERS' European Economic Simulation Model (ESIM) was used to make a preliminary analysis of the impact on the EU-15 grain sector (wheat, barley, corn, and other coarse grains) if these changes are made to the arable crops regime, focusing on the period 2000/01-2005/06. The baseline sce-

nario forecasts are based on continuation of the CAP in its current form. (It should be noted that the model used to produce baseline results was modified for the purposes of this analysis, and these results are not the same as those contained in the official USDA publication, *International Agricultural Baseline Projections to 2005*).

The model was then adjusted to include the proposed changes outlined above: 1) the grain intervention price was lowered by 20 percent, 2) the compensatory payment was increased to 66 ECU/ton, and 3) the set-aside was put at zero, all beginning in marketing year (MY) 2000/01. All other variables were held constant, and it is assumed that restrictions on oilseed area, which were negotiated during the Uruguay Round (UR), remain in place. Since the ESIM model does not cover protein crops, the effect of the proposed changes on these commodities is not included in the results. It should be noted that the share of protein crops in total arable crop area is small relative to grains and oilseeds, and omitting them from the model shouldn't have much effect on the results.

Proposed Changes to CAP Lead to Increased Grain Output and Exports

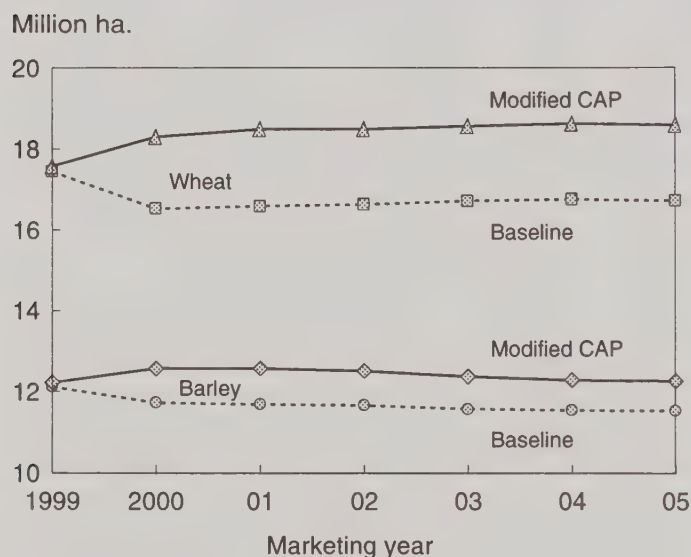
The removal of the compulsory set-aside has a significant effect on area sown to grain. Compared to the baseline scenario (which assumes a constant 12 percent set-aside), the zero set-aside results in a nearly 10-percent increase in sown area to grain in 2000/01, with most of this growth occurring in wheat area (figure 6). The increase offsets the effects of a projected decline in the rate of growth in yields, which slows slightly due to lower prices and input use, so that grain production rises relative to the baseline scenario.

While some of the increase in production is absorbed by higher feed use (due to the lower prices) and seed use (due to increased sown area), a projected 33 million tons (60 per-

cent higher than the baseline scenario) of exportable grain surplus remains, which rises to 43 million tons in 2005/06 (up 40 percent from baseline) (figure 7). It should be noted that some of this surplus could go into intervention stocks and some reports indicate that the Commission wants to hold higher stocks relative to current levels.

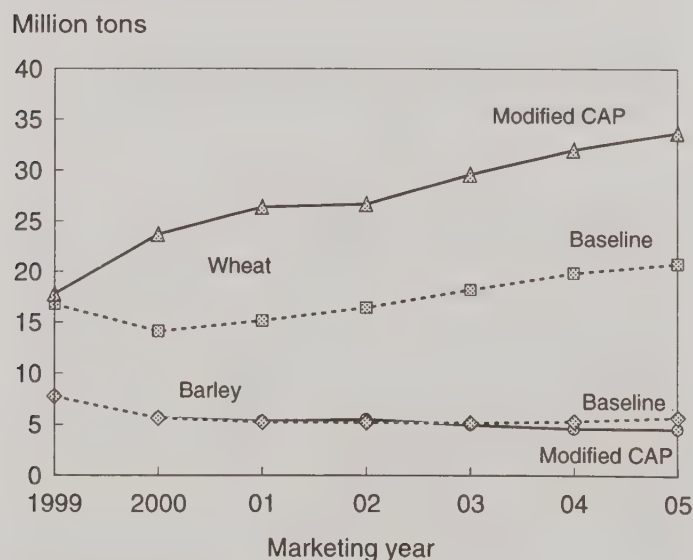
In the reform scenario, wheat comprises nearly 80 percent of this exportable surplus in 2005/06, compared to around 70 percent in the baseline. Given that the intervention price for all grains under the modified CAP scenario is supposed to be roughly equal to the world price of wheat, much of this surplus may not require export subsidies, therefore

Figure 6
Wheat, Barley Area Increases Under Modified CAP



Source: ERS estimates

Figure 7
Under Modified CAP, Wheat Exports Rise



Source: ERS projections.

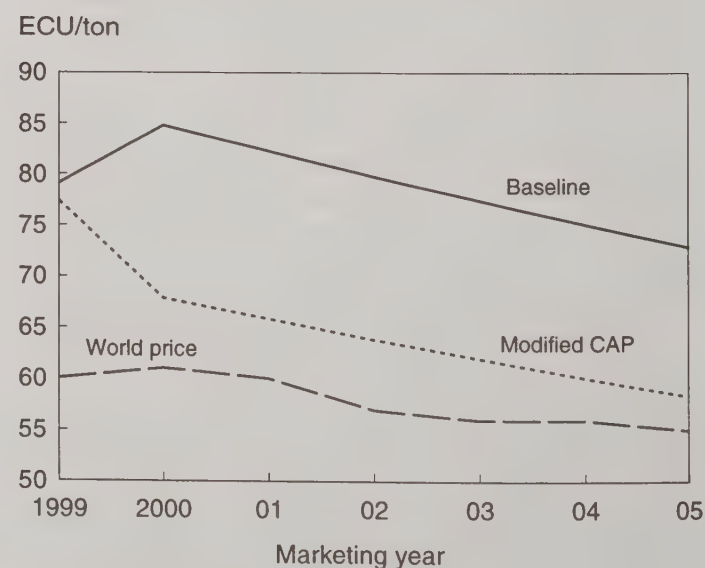
reducing the effect of WTO-imposed constraints on exports. (The EU might still use export subsidies to increase competitiveness in a given market). However, the increase in exportable surplus could also affect other exporters (including the United States), because EU exporters will have to find markets for their surplus grain, thus leading to highly competitive market conditions and possibly lower world prices. (This analysis did not gauge the effect of the modified CAP on world markets, because the ESIM results were not put into ERS' LINKER program, which balances world supply and demand and produces equilibrium world prices).

The situation for barley is different because it receives the same intervention price as wheat, which is higher than the world price for barley, so that exportable barley surpluses will continue to require export subsidies (figure 8). In order to remain within WTO export subsidy limits, the EU internal market price for barley falls relative to the baseline scenario. The lower price encourages increased feed use inside the EU, and therefore exports would be lower than under the baseline.

Effect of Changes to CAP on Subsidy Commitments—Implications for the Next Round?

As illustrated above, the proposed changes to the arable crops regime do not appear to resolve the problem of grain surpluses, as both grain production and exports increase relative to the baseline scenario. While wheat exportable surpluses wouldn't be constrained by WTO disciplines on export subsidies (as long as the intervention price is roughly equal to the world price after MY 2000/01), barley surpluses would require export subsidies. This is because EU internal barley prices remain higher than world prices (especially as noted above, the world prices used in the model do not

Figure 8
EU Barley Prices Remain Above World Levels



Source: ERS projections.

reflect the increase in EU output, which would push world prices down further).

In addition to export subsidies, the EU is required as a member of the WTO to reduce the support provided to its producers. It is interesting to examine how proposed changes to the arable crops regime could affect the level of support to grain producers by looking at the domestic support levels agreed during the Uruguay Round. Identifying reductions in support to producers of certain commodities may also provide some insight into the EU's willingness to make further cuts in domestic support in the next round of WTO negotiations on agriculture.

Under the Uruguay Round Agreement on Agriculture (URAA), the reduction commitment pertains to the total value of domestic support, aggregated across all commodities, rather than on individual commodities or commodity groups. Reductions are measured against the total value of support in the base period (1986 to 1988). The total value of domestic support is the sum of the support levels calculated for all products, including, for the EU, common wheat, durum wheat, and barley. The two primary components of domestic support to EU grain producers are market price support (calculated as the difference between the intervention price and a fixed reference price, times the quantity eligible for support), and direct income support (compensatory payments).

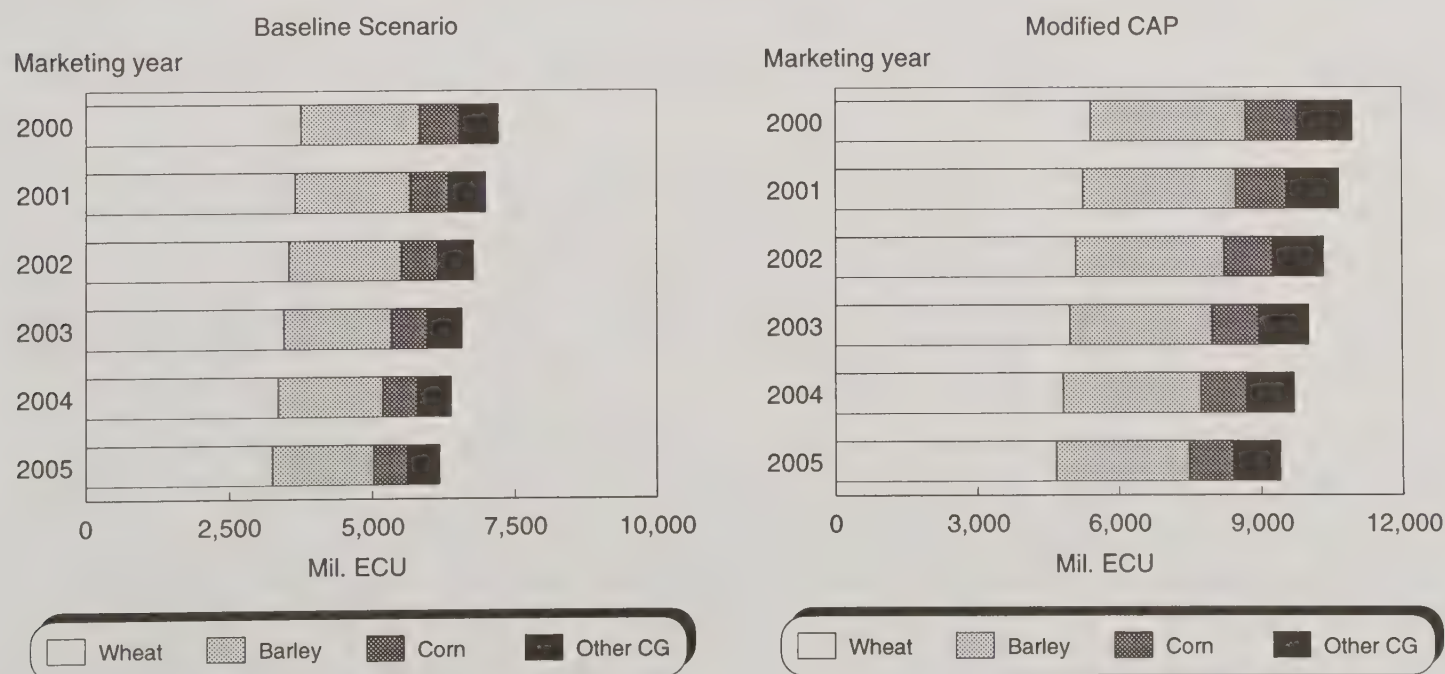
A number of elements will influence how the EU's level of domestic support changes: The difference between EU

prices and the fixed reference price, the quantity of EU production eligible for support, and the value of the compensatory payments. The 1992 CAP reform reduced the gap between the EU and the external reference price significantly, and it would fall further still under the proposed changes, although a small positive price gap (relative to the reference price) would still remain. Production would be considerably higher in MY 2000 than in the base period, but market price support would be much lower because of the significantly smaller price gap. However, the direct income support component would be significantly higher, because of the higher compensatory payments. Compared with the current payment system, compensatory payments for all grains are forecast to increase 50 percent from the baseline scenario, because the payment rate for grains is increased in the modified CAP scenario and area harvested rises due to the zero set-aside (figure 9).

Under currently proposed CAP modifications, the expected decrease in market price support for grains could indicate that the EU may be more willing to make further cuts in the aggregate level of support in the next WTO round. However, this will depend on how the EU's compensatory payments, which are now exempt from reduction under the Aggregate Measurement of Support (AMS) (see box), are treated. An additional consideration would be the levels of support for commodities for which no real reductions have been proposed or adopted (for example, dairy products).

If compensatory payments are not considered exempt, for reasons discussed in the box, the EU may be less willing to

Figure 9
Modified CAP Leads to Higher Compensatory Payments



Nominal prices. Estimates.

WTO Agricultural Support Disciplines and the Next Round

Under the Uruguay Round (UR), developed member countries agreed to discipline trade-distorting domestic support to agriculture by capping it at 1986-88 average levels, and reducing it 20 percent over 6 years (1995-2000). The aggregate measurement of support (AMS) was developed to quantify trade-distorting support, such as market price support, input subsidies, and direct payments. During each year of the implementation period, members must submit a current year AMS, as well as notify the WTO of any new policies that are introduced.

Policies considered to have little or no trade-distorting effect are exempt from a WTO member's reduction commitment. These are often called "green box" measures, and include general services that benefit producers and the rural community (such as research, extension, inspection, pest/disease control, etc.) and direct payments to producers that meet specific policy criteria (generally, all direct payments cannot be related to production type, volume, prices, or factors of production in any year after the base period). All green box programs must be publicly funded and cannot provide price support.

However, Article 6:5 of the URAA exempts from reduction programs that are production-limiting and meet specific criteria. Referred to as "blue box," the criteria for these programs are: 1) payments based on fixed area or yields; or 2) payments made on 85 percent or less of the base level of production; or 3) livestock payments made on a fixed number of head. Examples of blue box policies are U.S. deficiency payments (pre-FAIR Act, see below) and the EU's acreage and headage payments.

The blue box provision was primarily developed to accommodate the EU's 1992 CAP reform, which lowered intervention prices and introduced a system of compensatory payments based on fixed area and yields for eligible crops (grains, oilseeds, protein crops) and on a fixed number of head for cattle and sheep/goats. Without the blue box provision, these payments would have been included in the total AMS and subject to reduction. The EU was unwilling to modify its recently adopted CAP reform, which did not provide for reductions in the compensatory payments.

Many observers believe that CAP reform was a key factor in determining the terms (or limits) of agricultural liberalization during the Uruguay Round. Since CAP reform resulted in lower support prices, it was easier for the EU to make changes to border measures, such as converting variable levies to tariffs, and to discipline export subsidies. However, other countries participating in the Uruguay Round had to make compromises to gain the EU's support for the entire package, and in the end, disciplines on domestic support were diluted.

For example, initial proposals included reductions to commodity-specific support, not an aggregated level of support, as was agreed to in the final version of the Agreement. Reducing commodity-specific support would have been much more difficult for the EU and other countries with high levels of support (such as Japan, Korea, and Norway). Second, the blue box provision enabled the EU (and the United States) to exempt direct payments, which are trade-distorting, from its overall reduction commitment. Another area of compromise to gain EU support was the inclusion of the "peace clause" (Article 13 of the Agreement), which shields domestic support (and export subsidies) provided in conformity with the Agreement from countervailing duties and other WTO actions.

While it is not clear if the proposed changes to the CAP will be adopted, they may indicate the degree to which the EU is prepared to make further progress in liberalization in the next round of agricultural negotiations, which are scheduled to begin in 1999. Strengthening internal support disciplines will probably be a key component of the next round, since many countries (especially those in the Cairns Group) feel that insufficient progress was made in this area during the UR. If these proposals reflect the EU's limits on reducing domestic support, there will likely be many WTO members who feel that these changes do not go far enough in terms of achieving greater liberalization. As a result, these countries may be less willing to make compromises, as was done during the last round.

Moreover, if the EU is one of the few members still using the blue box provision, there could be increased pressure from other WTO members to discipline this support as trade-distorting. The United States, which notified its deficiency payment system as blue box in its 1995 notification, has replaced these payments with decoupled production flexibility contract payments, which are consistent with green box criteria. Under the proposed changes the EU has outlined, its compensatory payments would still be tied to production (because they are based on the actual area planted) and therefore would not fall into the green box.

commit to further reductions in domestic support. Results of the ESIM analysis were used to arrive at a rough estimate of EU levels of support for common wheat, durum wheat, and barley in the year 2000. Because of differences in product aggregation and country coverage, the model results are not precisely the same as the information in the base period calculation. For common wheat, the reduction in market price support is quite sizeable, and the reduction in support, even if the compensatory payments are included, is greater than 20 percent. By contrast, under both the baseline and CAP-reform scenarios, the estimates for barley and durum wheat indicate that the level of support including the compensatory payments may not decline by the full 20 percent. In the case of barley, part of the explanation is that the intervention price remains significantly higher than the external reference price, so that the reduction in market price support is not as great as for common wheat.

Proposed Modifications to CAP Also Reflect Cost Of Enlargement

The cost of expanding the EU to include Central and East European countries has been mentioned as a reason to make changes to the CAP. If no changes are made to the CAP, and assuming that compensatory payments are extended to acceding CEE countries (which may not happen for reasons discussed below), ERS has estimated that accession of the Visegrad Four (Poland, Hungary, Czech Republic, and Slovakia) could cost an estimated \$3 billion (around 5-6 percent of the annual CAP budget) annually just to cover the costs of intervention purchases, compensatory payments, and export subsidies within WTO limits (See "Enlargement

to Transform European Agriculture," *Europe International Agriculture and Trade Report*, January 1997).

In addition, extension of the CAP in its current form to CEE countries is forecast to result in higher production of most commodities, which will be difficult to absorb internally (within even an expanded EU). The increase in output will put pressure on EU internal prices, the budget, and the EU's ability to meet domestic and export subsidy reduction commitments. These issues could be resolved if changes to the CAP are made, such as the ones currently under discussion, and compensatory payments are not extended to the CEEs (on the basis that since EU prices are higher, not lower, than CEE prices, CEE producers are not expected to incur any loss in income).

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CEE State Trading: Questions Lurk Behind Notifications

Four of the CEEs—Poland, Slovenia, Slovakia, and the Czech Republic—have notified the WTO of the existence of state trading enterprises (STEs). However, questions persist despite these notifications. There are state-owned enterprises in other CEEs that meet the WTO definition of an STE but that have not been notified. For STEs that have been notified, a lack of good data makes it difficult to evaluate the full impact of state trading. [Nancy Cochrane]

Since the conclusion of the Uruguay Round, there has been a growing interest in the issue of state trading. Regarded as one piece of unfinished business, state trading is expected to be an issue for the next round. There are several reasons for the interest in this issue. First, the definition set forth in the Uruguay Round is vague—there is considerable ongoing debate, for example, as to whether certain countries fit the definition of a state trader. Second, there is some concern that state trading may be used to circumvent the strict limits on import tariffs and export subsidies laid out in the WTO Agreement. Third, since the signing of the WTO Agreement, several countries have set up new state trading enterprises (STEs) to implement the tariff rate quotas. Finally, Russia and China are now negotiating the terms of their accession, and both countries make extensive use of STEs to regulate their foreign trade.

Most of the U.S. interest in state trading focuses on the larger players in international markets, such as the Canadian and Australian Wheat Boards and the Japan Food Agency. But the Central and Eastern European (CEE) countries are also of interest. Since the beginning of the transition, many of them have established regulatory agencies that carry out intervention purchasing and administer export subsidies. In most cases these agencies have been notified as state trading enterprises to the WTO. In other CEEs the state-owned foreign trade organizations (FTOs), which had a monopoly before the transition, have retained much of their influence over imports and exports. While no one of the CEEs has a great influence on world markets, taken together, they represent a large potential market for some commodities and significant potential competition in others. And because of still underdeveloped markets and information systems, the STEs in the CEEs have considerable influence on domestic and foreign markets that is still difficult to measure.

What Is State Trading?

STEs first were recognized as legal entities under the 1947 General Agreement on Tariffs and Trade (GATT). The 1947 GATT required that STEs adhere to the general principles of non-discriminatory treatment and, recognizing that the operations of STEs might impede trade, allowed for negotiation

between GATT members to reduce such impediments. To clarify the types of enterprises that can be defined as STEs, an official definition of state trading enterprises was adopted in the Uruguay Round:

Governmental and nongovernmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports.

Why Are STEs of Interest?

The exclusive or special privileges conferred on an STE give it the power to greatly influence the quantity and price of exports and imports. Its activities can result in significant import barriers or de facto export subsidies. The actions of an STE cannot create non-tariff barriers to imports, and they cannot result in export subsidies that exceed the WTO limit. A lack of transparency in many STEs' pricing practices often makes it difficult to determine if they are within GATT limits

Several types of STEs have been identified. The most common in agriculture are statutory marketing boards, which are government-sanctioned monopolies with exclusive control over functions such as purchasing domestic production, conducting foreign trade, or setting producer or consumer prices. Similar to those are regulatory marketing boards, which, while maintaining control over imports and exports, do not directly engage in foreign trade but contract with private trading companies to carry out the actual operations. Another type is the foreign trade organization, which used to be typical of the centrally planned economies. The most commonly stated objectives of STEs are price stabilization, export promotion, income support for producers, and food security. The products most commonly regulated by these organizations are grains (particularly wheat) and dairy products.

Previous work done at ERS developed a classification scheme that is helpful in understanding the impact of STEs on imports or exports, as well as their potential for circum-

venting WTO commitments.³ The key distinguishing characteristics that have been defined are:

- Trade balance: Is the STE an import or export-oriented STE?
- Market regime: To what extent does the STE exert control over a) exports or imports, (b) domestic marketing, c) commodity procurement and d) processing?
- Policy regime: Which policy tools (export subsidies, tariff rate quotas, supply controls, price support, marketing of imported goods, etc.) are available to the STE.
- Ownership: Government, producer group, or otherwise;
- Products regulated.

Export-oriented STEs can subvert WTO limits on export subsidies through price pooling and excessively discriminatory pricing. An STE that engages in price pooling typically pays producers a percentage (perhaps 80 percent) of the expected final price on delivery. The final price paid to producers is a blended price based on net revenue from all sales in domestic and international markets. Price pooling can make it easier for an STE to engage in price discrimination, charging high prices in domestic markets while subsidizing exports.

STEs also have the advantage of lower costs in the form of government-backed credit and less risk. Depending on the extent of its monopoly on purchasing, an export STE has an assured supply of raw product. Even if it is not a true monopsony, the availability of low cost-credit may give it an advantage over other purchasers. It can make forward sales at set prices without worrying about supply availability at time of delivery. It thus faces a lower credit risk than private organizations. It also has greater freedom to make export sales commitments and has an advantage in reaching long term agreements with importing countries.

Import STEs influence domestic production and pricing as well as imports. Some import STEs are the sole importers of certain products; others influence imports through contracting arrangements or licensing. Some establish markups for commodities imported under TRQs, control processing and distribution of imported goods, and conduct quality and safety inspections. Importing STEs can use their power to block imports even when a market exists in the country, raise the price of imported products by limiting distribution (keeping imported products out of certain markets) or discriminate among suppliers for political reasons. If a country allows an STEs operations to provide import protection at levels above the bound tariff rate, it can be considered to be in violation of its GATT commitments.

³Ackerman, Karen, Praveen Dixit and Mark Simone, "State Trading Enterprises: Their Role in World Markets," *Agricultural Outlook*, June 1997/AO-241, Economic Research Service, United States Department of Agriculture.

It is by no means the case that all STEs are violating WTO rules in these ways. The problem is that without good information on prices paid for imports, markups for sales in domestic markets, and average producer prices compared to average export prices, it is impossible to judge whether the rules are being circumvented.

Do the CEEs Engage in State Trading?

According to the above definition of state trading, the two criteria on which to assess the existence of state trading are:

- 1) The organization has a special right or privilege.
- 2) In the exercise of these rights, the organization influences the level or direction of trade through its trading activities.

There is hardly any question that during the Communist period all the CEEs engaged in state trading. Virtually all foreign trade was carried out by state-owned foreign trade organizations (FTO), which generally had a monopoly over trade in given commodities. Imports and exports were controlled by the central government through extensive use of non-tariff barriers that were often non-transparent.

After 1989, the monopoly status of the FTOs was abolished, as were most quantitative restrictions on trade. All firms, private and state were given the right to engage in foreign trade, and private companies now conduct an increasing share of imports and exports. Many of the old FTOs still exist, but most no longer have a monopoly and many are in various stages of privatization.

While none of the CEE governments control foreign trade to the extent they did before 1989, state trading by the above definition does exist in most of the CEEs. In some cases the old FTOs and other state-owned enterprises retain much of their former influence, even though they are no longer monopolies. Often these state enterprises receive benefits from the state that are not available to other firms. In other cases CEE governments have created regulatory agencies responsible for administering the government intervention programs. These agencies in most cases meet the WTO criteria for state trading and have been notified (identified to the WTO) as state trading enterprises. While there is no evidence that they have been used to circumvent WTO commitments, these agencies have significantly affected domestic and international trade in the CEEs and could be used in this way. The problem is that inadequate data and market information make it difficult to determine the full impact of these state trading activities on imports and exports.

The Regulatory Agencies Notified to WTO

By the two criteria, the various state intervention agencies that have been established in Poland, the Czech Republic, Slovakia, and Slovenia since the early 1990s qualify as STEs. These agencies include the Agricultural Market

Agency (AMA) in Poland, the State Funds for Market Regulation in the Czech and Slovak Republics, and the Agency for Commodity Reserves in Slovenia (table 4). These were created in response to the drastic decline in producer income that occurred immediately following the beginning of the transition. Their principal role is to establish and support minimum prices for key commodities and stabilize prices of other commodities through intervention purchasing. However, to support minimum prices and avoid buildup of excessive stocks, they are also involved in subsidized exports. They are also responsible for allocation of domestic quotas to commercial firms for intervention purchases and export subsidies.

These agencies are involved in both imports and exports, except for Slovenia's Agency for Commodity Reserves, which only deals with imports. All are government owned. Through their activities they can influence all four market activities identified in Ackerman et al. (imports and exports, domestic marketing, procurement, and processing). But they do not have 100 percent control over any of these activities. The instruments used are guaranteed minimum prices, intervention purchasing, and export subsidies.

These agencies do not engage directly in foreign trade but contract with commercial trading companies to undertake imports or exports on their behalf. None of them can be said to have an absolute monopoly on foreign trade, and none of them engage in price pooling. But through their intervention purchasing, they are heavily involved in domestic procurement. The Polish AMA is also involved in processing. All

these agencies by their very nature enjoy privileges not granted to other trading entities and to that extent conform to the definition of state trading. The privileges are for the most part in the form of direct government funding and government backed credit. Because of these special privileges, the governments of Poland, Slovakia, and the Czech Republic have notified the WTO of the existence of state trading in their countries.

Hungary maintains it has no state trading. Decisions on agricultural market support are made and implemented by the Agricultural Market Regime, which is an inter-Ministerial committee with representatives from the Agricultural, Foreign Trade, and Finance Ministries. This committee makes decision on levels of producer support and subsidized exports. The actual operations are carried out by commercial companies selected through tenders. The Hungarians maintain that this office is not a state trading enterprise because it is a government committee that does not engage in commercial activities.

Poland's AMA was first established in 1991. Its primary function at that time was to stabilize commodity markets through intervention purchasing—buying up stocks when prices were falling and releasing them back onto the market when supplies were tight. Its role expanded in 1992 when it was given authority to set guaranteed minimum prices for wheat, rye, and dairy products, which it supported through intervention purchasing. Since 1992 its role has expanded still further, and it is now involved in the management of the

Table 4--CEE State Trading Agencies as Notified to WTO

Country	STE	Ownership	Commodities	Policy instruments
Poland	Agricultural Market Agency	Government	Wheat Rye Dairy products Pork Sugar Wool	<ul style="list-style-type: none"> o Sets minimum prices o Conducts intervention purchasing o Provides credit guarantees to authorized warehouse purchasing wheat at minimum price o Provides 45 percent advance payment to producers who keep their wheat in storage o Authorizes subsidized exports o Buys and sells for strategic reserve
Czech Republic	State Fund for Market Regulation	Government	Food wheat Butter Skim milk powder Cheese Malt	<ul style="list-style-type: none"> o Establishes minimum prices o Authorizes intervention purchasing on its behalf through tenders o Administers export subsidies
Slovakia	State Fund for Market Regulation	Government	Food wheat Live cattle, Beef, Pork, Dairy products, Poultry and eggs, Sugar Potatoes, Starch	<ul style="list-style-type: none"> o Establishes minimum prices o Authorizes intervention purchasing on its behalf through tenders o Administers export subsidies
Slovenia	Agency for Commodity Reserves	Government	Wheat Sugar	<ul style="list-style-type: none"> o Establishes minimum price o Conducts intervention purchasing o Authorizes import of duty free quota for wheat o Subsidizes sales to flour mills

strategic reserve and in providing preferential credit to grain producers and warehouses.

Currently, the AMA intervenes in grain markets in the following ways:

- Direct intervention purchasing, using funds provided by the state budget. This accounted for 31 percent of all intervention purchases in 1995/96.
- Procurement through a network of authorized warehouses. The warehouse agrees to purchase wheat at the intervention price and in return AMA provides guarantees for preferential credit to the warehouses. After 3 months, period the AMA will purchase the grain at the intervention price plus storage, interest and handling. This accounted for 51 percent of all intervention purchases in 1995/96.
- Advance payment to selected producers. Wheat producers who are willing to store at least 100 kilograms of wheat can receive an advance payment of 45 percent of the intervention price. The producer is obliged to leave the grain in storage for 3 months. At the end of that period, the producer can either repay the advance plus interest in cash, or forfeit 45 percent of the grain to the Agency and take back the remaining 55 percent, which can either be used on farm or sold on the open market. This accounted for 18 percent of all intervention purchases in 1995/96.

The AMA also sets and administers minimum prices for dairy products and carries out intervention purchasing of pork and sugar. It also periodically engages in the import and export of these commodities; some of the exports have been subsidized. It does not directly engage in trade, but contracts with commercial companies to carry out the transactions on its behalf. In the early years of its existence, the AMA had a substantial share in the foreign trade of certain commodities. In recent years its share in foreign trade has been lower, but it still has the authority to carry out foreign trade directly.

The AMA also maintains the strategic reserves and periodically buys into or sells from that reserve. Not only is the size of the reserve kept secret, but the AMA also does not divulge the size of purchases or sales from the reserve.

The Czech and Slovak State Funds for Market Regulation (SFMR) were created on similar objectives as the AMA—to stabilize prices and maintain producer income. Both operate on similar principles. They regulate the market for key commodities through intervention purchasing or subsidized exports. Neither engages directly in either domestic purchasing or foreign trade, but contract with commercial companies to act on its behalf. These companies are selected through tenders. Import licenses, with the exception of imports under TRQs, are granted automatically. However, the Funds have restricted export licenses (particularly for

wheat) in the interest of keeping sufficient supplies within the country. Licenses for imports under TRQs are issued by the Czech customs authority on a first-come, first-served basis. The Import Licensing Division of the Slovak Ministry of Economy on behalf of the Ministry of Agriculture allocates imports under the TRQs.

The main difference between the two countries is the number of commodities regulated and the extent of intervention. The Czech Republic only regulates food wheat and dairy products: wheat through intervention purchasing and dairy products through subsidized exports. Slovakia intervenes in a broader range of products, including grain, live cattle and beef, pork, dairy products, poultry and eggs, sugar, potatoes, and starch.

Slovenia. The Slovenian Agency for Commodity Reserves is a particularly interesting case, since it appears to have a far more pervasive influence on trade of wheat and sugar than any of the agencies described above. The agency is the only authorized purchaser of wheat, which it buys at a very high minimum price set by the government. It also contracts with commercial firms for the import of a duty free quota of wheat. The Agency then sells the wheat to the flour mills at a price that is between the high internal price and the import price. Other firms are free to import, but must pay the published tariff rate. Intervention in the sugar market is quite similar, except that purchasing is carried out by a commercial company that has a monopoly on the Slovenian market.

State Trading in Romania and Bulgaria. State trading takes a different form in Romania and Bulgaria. Neither has an agency analogous to the AMA in Poland, and both governments have notified the WTO that they have no state trading enterprises. However, the purchasing and foreign trade of bulk commodities in both countries continues to be heavily dominated by state-owned companies, and the governments have played a major role in manipulating domestic prices and levels of foreign trade. But these activities have not generated much concern among exporting countries because their primary impact has been to restrict exports rather than to undercut export markets or impose hidden import barriers. Moreover, both countries are in a state of accelerated transition. They are under pressure from international lending institutions to speed up the privatization process, allow greater competition, and to allow the non-viable state enterprises to be shut down.

In Romania the former Romcereal had a virtual monopsony on the procurement of wheat. Almost all marketed wheat was purchased by Romcereal at prices that were barely half the world level. Romcereal did not engage directly in foreign trade, but controlled most storage and the supply and prices charged to potential exporters. In June 1995, Romcereal was dismantled. Part of it was reorganized as the National Agency for Agricultural Products (ANPA); the remainder was split into several commercial companies,

called Comcereal. These companies are eventually to be privatized, but at the moment most are majority state-owned. Furthermore, the functions of ANPA are rather broadly defined, to include purchasing, storage, and reserve management. In the year since the reorganization, virtually all the Comcereal companies remain majority state owned, and there does not appear to have been any increase in competition among purchasers of wheat.

More seriously, all the grain silos at Romania's largest port of Constanta are owned by a majority state owned company, Agroexport. The director of this company has considerable power to control the flow of exports out of the country, thus affecting the domestic market price.

This situation could have led to low-priced exports that undercut the world market, especially in 1995/96, when Romania had a wheat surplus of close to 2 million tons. But because of government policies intended to maintain stable supplies of low-priced bread, combined with bottlenecks in the local infrastructure, the Romanians were unable to take advantage of their surplus. The capacity of the port of Constanta was too low, and transportation was inadequate to move the grain to the port. In 1996/97 there was no exportable surplus, the result of a drastic decline in area planted and a very harsh winter.

There is no single agency in **Bulgaria** that can clearly be identified as a state trader. But much of the purchasing, processing, and foreign trade, particularly of grains, continues to be carried out by companies that are still majority state-owned. These companies receive benefits from the state that are not available to private companies. For example, after the 1997 harvest, the Agricultural Minister made available about 260 billion leva (US\$146 million) for low interest loans to a select group of mills to enable them to purchase the 1.1 million tons of wheat that officials estimated was necessary for the nation's food supply. Ministry of Agriculture officials have stated that both state and private mills could apply for this credit. However, it has happened that all the credit was granted to enterprises in which state ownership was over 50 percent. These included 27 state mills. The largest, Zarneni Chrani, obtained the highest purchasing quota, 843,000 tons, which makes it nearly a monopoly on the grain market. Bulgaria has notified the WTO that it has no state trading enterprises, but these state mills, particularly Zarneni Chrani, appear to enjoy some of the benefits of state traders.

But both countries are on the brink of major changes. Romania elected its first non-Communist government last year, and the Bulgarian elections held last spring brought an opposition victory. Both governments are now committed to speeding up the market reform process, moving much more rapidly to privatize ailing state-owned firms and to get the government out of the business of controlling domestic prices. The Romanians have pledged to privatize all the

Comcereal companies, and the Bulgarians intend to split up Zarneni Chrani and privatize the new companies.

Issues for the Next Round

The key question for the next round of trade negotiations is not so much the existence of state trading in Central and Eastern Europe, but whether state trading is used by these governments to circumvent the commitments made to the WTO on import tariffs and export subsidies. On the surface it would appear that these state trading institutions are not used in this way. While high, tariffs imposed by the CEEs do not exceed the bound levels. As for export subsidies, only Hungary has exceeded its commitment, and this cannot be said to be due to state trading. Calculations by OECD indicate that aggregate Producer Subsidy Equivalents (PSEs) throughout the CEEs are quite low relative to Western Europe.⁴

Yet, there are a number of reasons why this will be an issue for the next round. For one thing, the definition of state trading is vague, allowing some governments to notify the WTO that they have no state trading, when in fact they do have institutions that meet those criteria. Another major problem is that these institutions in many cases affect levels of imports and exports in ways that are not easily measured. Published tariff rates and PSE calculations based on price gaps do not tell the whole story.

The definition problem. Hungary, Romania, and Bulgaria have all notified the WTO that they do not have state trading enterprises. The Hungarians maintain that the Market Regime Office is a government agency of representatives from three different Ministries and is not an enterprise. But it performs the same functions as the SFMR in Slovakia and the Czech Republic. At the same time the Hungarian Holstein Breeders Association has been granted the exclusive right to import bull semen and there are charges that it regulates the flow of imports by charging a higher price for imported product than for domestic. But the Hungarians argue that this can't be a state trader because it is not a state-owned organization. The Romanians and Bulgarians maintain that enterprises such as Zarneni Chrani or Agroexport are commercial companies that enjoy exactly the same rights as any other commercial company. Yet these are state-owned companies that receive special privileges (such as low interest credit) which are not equally available to all.

Impact on trade levels. The intervention agencies in the CEEs have considerable influence over the domestic market for key commodities, particularly grains. These STEs do not

⁴The producer subsidy equivalent, or PSE, is an aggregate measure of the value of all transfers to producers of a given commodity. It has been defined by ERS as "the level of subsidy that would be necessary to compensate producers (in terms of income) for the removal of government programs affecting that commodity" (*Government Intervention in Agriculture, Measurement, Evaluation, and Implications for Trade Negotiations*, FAER-229, U.S. Dept. Agr., Econ. Res. Serv., 1987).

have a monopoly on either domestic or foreign trade of the commodities they regulate. However, the funds available to them through the state budget and other special privileges they receive gives them a significant advantage over private traders. This market power gives them the potential to violate the principles of WTO, but it is not clear that they have done so. The main problem is a lack of transparency in their operations that makes it difficult to assess the extent to which this may have happened.

One problem is a lack of reliable data. Official Slovenian tariff rates, for example, are right at the bound levels, but it is clear that the Agency for Commodity Reserves has considerable power to regulate imports. But the price data needed to calculate the true tariff equivalent of its activities are not available, and Slovenian economists complain that the activities of the Agency are not at all transparent. Likewise, charges that the Hungarian Holstein Breeders Association engages in price discrimination are only hearsay. The data needed to support or refute such charges are not available.

According to OECD calculations of PSEs, the impact of the Czech and Slovak Funds on wheat prices has been minimal (PSEs are negative), even though the volume of wheat exports subsidized by the Funds has been substantial in some years (table 5). The Funds' influence on dairy markets is much more evident, however. In most years, for example, the Slovak Fund has accounted for two-thirds or more of that country's exports of cheese, skim milk powder, and butter, and PSEs calculated by OECD for these commodities are relatively high (39 percent for the Czech Republic, 49 percent in Slovakia).

In general, the SFMRs have a considerable role in determining the quantities that are imported or exported. They have been the agencies that imposed export bans (especially of grains) when there were shortfalls. However, export bans, while they distort the domestic market, are not of much concern to major exporting nations, since if anything they create more opportunities for export. The agencies' influence on import levels is less direct, since WTO prohibits quantitative restrictions on imports. But their regulation of the domestic market does affect the level of imports.

**Table 5--Subsidized Exports of State-traded Commodities:
The Czech Republic, Poland and the Slovak Republic, 1995**

Country/Commodity	Czech Republic	Poland	Slovak Republic
	1,000 tons		
Beef	22.8	0.7	0.2
Cereals	1,274.4	0.0	0.0
Malt	205.4	0.0	94.3
Milk powder	70.3	0.0	7.1
Other dairy products	80.1	0.0	6.5
Pork	1.7	0.0	0.0
Poultry and eggs	12.8	0.0	0.1
Starch	3.4	0.0	0.0
Sugar, sugar confectionery	95.8	0.0	0.2

Source: Countries' notifications to the World Trade Organization Committee on Agriculture.

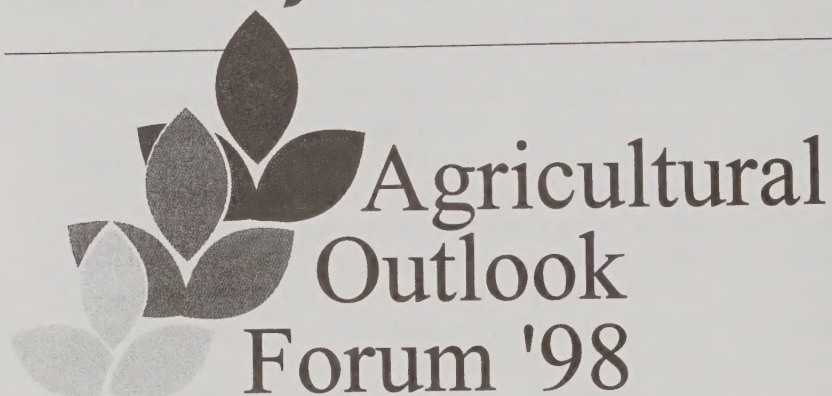
The Polish AMA engages in foreign trade to a lesser extent than the SFMRs. However, it is authorized to engage in foreign trade and will export stocks that cannot be sold on the domestic market, often at a loss. But it is not clear whether these exports are included in Poland's official reports of export subsidies. For example, early in 1997 the AMA purchased 109,000 tons of pork. Of that, 69,000 tons were released onto the domestic market later in the year and an undisclosed amount was exported, primarily to the Former Soviet Union. The AMA did not export directly, but contracted with a number of firms to act on its behalf. An official of the AMA said that most of this pork was exported at a loss, but maintained that this did not constitute an export subsidy because no payment was made to the exporting companies. It is difficult to determine the extent to which these AMA pork exports were subsidized. The volume of AMA exports is known, but it is more difficult to determine the prices at which the pork was exported.

The full impact of the AMA on Poland's domestic and international trade is further obscured by the fact that the AMA is responsible for both intervention purchasing and buying and selling for the strategic reserve. This dual responsibility creates considerable potential for conflict of interest. These are two separate functions, and both activities can affect the market, but the transactions on behalf of the strategic reserve are a state secret.

Finally, the fact that levels of market price support calculated by OECD are generally low can be misleading. OECD calculates market price support based on the gap between domestic prices and a world reference price. One obvious problem is the choice of a reference price. But leaving that issue aside, there is a more fundamental problem with this method. In a transition economy there are two basic factors that contribute to a price gap. One is the active intervention measures taken by governments—price supports, export subsidies, tariffs, etc. But another factor is that most of the countries still suffer from serious bottlenecks in the processing and distribution sector, and the effect of these bottlenecks is to depress producer prices. Without any overt government support, these institutional rigidities would result in prices well below the world level. Thus it can easily be the case that the impact of very high overt government support can be hidden in a calculation of market price support based on a price gap.

The influence of the STEs could wane as private markets become better developed, although arguably, their very existence is slowing down the development of those markets. But ultimately, the life of these agencies in their current form is constrained by these countries' impending accession to the European Union. With EU membership, these agencies will not be able to operate in the way they now do, but will likely become purchasing agents for the European Commission.

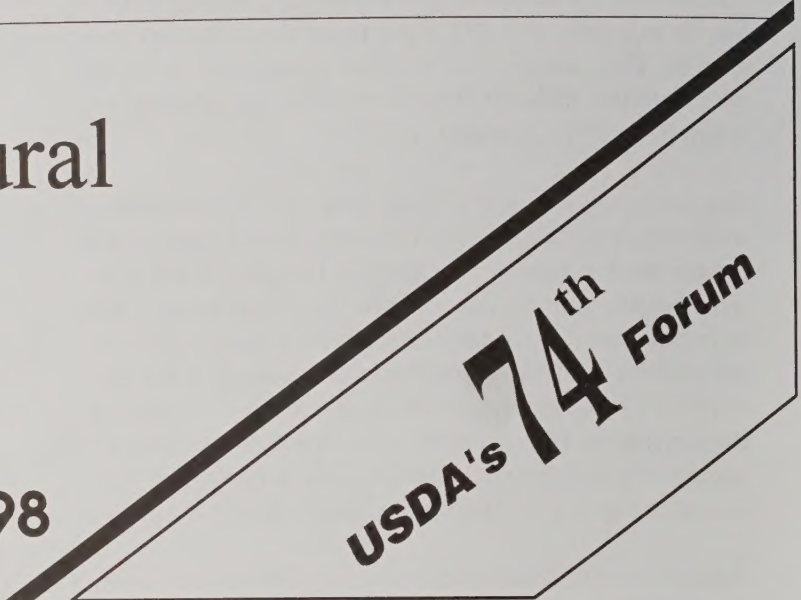
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